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Royal Commission on Banking and Finance

THE CANADIAN BANKERS' ASSOCIATION

Hearings held at

OTTAWA

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THE ROYAL COMMISSION ON BANKING & FINANCE

E R R A T A

VOLUME 61

Page	Line	
7878	28	add "s" to "risk"
7893	27	"average" should be inserted before "level"
	27	delete "instead of" and substitute "not having"
7894	3	Delete "that" and substitute "turnover"
	30	Delete "something" and substitute "sometime"
7895	7	Delete "may become" and substitute "became"
7896	19	Delete "under the" and substitute "to appraise"
7901	8,9	Delete "conventional", insert "N.H.A."
7910	13,14	Delete these lines and substitute "for short-run adjustments of cash positions. This question arises, it should be pointed out, in"
	19-21	Delete these lines and substitute "by Mr. Wadsworth earlier. There have been proposals that would have induced them to go further into this type of lending. However, I think it would be fair"
	25	"changed" not "change"
7912	10	Delete this line and substitute "made 100 per cent guaranteed after March 20, 1959. The"
7914	16	Delete "an essential" and substitute "as essential for the"
	26	Delete "changes" and substitute "suggestions"
7928	18	"schedule" not "table"
7936	19	Insert "had" after "we"
7937	6	Delete "using" and substitute "bringing in"
7938	23	Insert "of allocating costs" after "problems"
7942	30	Delete "to" and substitute "on"

ERRATA (Volume 61 cont'd.)

Page	Line	
7955	25	Delete "great" and substitute "much"
	26	Delete "a" and substitute "of an over-"
7956	2	Delete "You" and substitute "He"
	3	Delete "him" and substitute "you"
	7	Insert "showing" after "of"
	16	Insert "that" after "me"
	17	Delete "that" and substitute "people"
	18	Delete "people"
	19	Delete "go" and substitute "use"
	20	Delete "to"
7957	18-24	Delete these lines and substitute "These lines of credit are usually quite generous in relation to the net worth of the company concerned, and here I might interject that the majority of our over-drafts have to do with business loans, although perhaps the most vocal objection to them has been from the personal angle by and large. These lines of"
7958	4	"As stated," not "But as I say,"
7958	7	"security" not "securities"
7971	20	"term" not "terms"
	22	Delete this line and substitute "capital loans are generally for expansion purposes,"
	24	"receiving" not "making"
7972	2-3	Delete these lines and substitute "notwithstanding the removal of any inhibitions to the banks as far as rate or security is concerned."
7973	2	Delete "They" and substitute "RoyNat"
	3	Delete "the"
	4	Insert comma after "securities" and substitute "bonds" for "accounts"
7979	6	Delete "or lending customers"
	16	Delete "where their investment"
7998	26-27	Delete these lines and substitute "described. It would be"
8000	22	Delete "receivables" and substitute "inventories"
8001	3	Delete "in" and substitute "of"

E R R A T A (Volume 61 cont'd.)

Page	Line	
8001	29	Delete "on receivables, and under" and substitute "of receivables and"
	30	Insert "and" after "security"
8002	12	Delete "mortgage" and substitute "Section 88"
	30	Delete this line and substitute "be that business here probably get more sub-"
8003	1	Delete this line and substitute "stantial lines of credit - that is business which"
	3	Delete this line and substitute "88 the bank line of credit could not likely remain at its present"
8006	11	Delete "the" and substitute "a"
8007	4	Delete "was"
	15	Delete "project" and substitute "product"
8008	7	Delete "put-out" and substitute "payout"
8019	20	Delete "and", insert "of"
8025	4-7	Delete entirely and substitute "of the money market since 1954, and the development which has taken place much more recently of a fairly active trading market in commercial paper."
8025	11	Delete "rates" and substitute "rate"
	16	Delete "back" and substitute "backed"
8038	21	Delete this line and substitute "accounts, and are disposed to continue enjoying it. We"
8039	7	Delete this line and substitute "technical side about things I feel should be considered by"
	8	"a decision" not "the decision"
	18	"lower" not "lowering"
	30	Delete this line and substitute "Much would depend on what was done and what it was"
8040	22	Delete this line and substitute "the question of the reserve ratio is only one aspect of:"
8041	3	Delete this line and substitute "One might conceive of a formula that would"
	6	Delete this line and substitute "based on data that were not available promptly or because it would"

E R R A T A (Volume 61 cont'd.)

Page	Line	
8043	30	Delete this line and substitute "a Canadian case where there has been"
8044	10	Delete this line and substitute "a nominal kind of time deposit in order to get lower"
	14	Delete this line and substitute "ago, they took steps to make a very sharp"
	25	Delete this line and substitute "what ratios on demand and on time deposits are involved. I must"
	30	Delete this line and substitute "Banks have ranged up to 18 or 20 per cent at times,"
8045	2	Delete this line and substitute "3 or 4 per cent, or at least have been as low as that."
	4	Delete this line and substitute "pecially if the rate of interest on time"
	7	Delete this line and substitute "you put in there as to how the formula comes out."
8053	5-6	same paragraph
	6	"I suppose, however, that the ideal will"
	8	new paragraph starting "In terms of predicting"
	9-10	Delete these lines and substitute "is going to come about, I suppose that we as banks could claim that we are not"
	13-14	same paragraph
	15	Delete this line and substitute "that, with the rigidities in the system, it is"
	21-22	Delete these lines and substitute "but under certain circumstances -- when market rates, for example, tend to get above our rates -- there"
	23	"are" not "is"
8054	20	Delete this line and substitute "on monetary policy. You say that timing is"

ERRATA (Volume 61 cont'd.)

Page	Line	
8055	2	Delete this line and substitute "and we must not expect too much in the way of"
	6	Delete this line and substitute "anticipate such movements. You can say, for example"
8063	3	Delete this line and substitute "Of course, you could have the benefit of three good days instead, but"
8067	22	delete "takes", insert "wishes to take"
	27,28	delete "that is....." to end of paragraph
8068	11	correct spelling of "rings" (wrings)
8069	15	correct spelling of "beging" (begin)
8070	18	delete "usually"
8071	7	correct spelling of "rythym" (rhythm)
8084	8	delete "loan", insert "loss"
8085	25	Delete this line and substitute "in physical quantities--but rather in relation to"
8086	11	Delete "put-out" and substitute "payout"
8097	22	Delete "their" and substitute "the"
	27	Delete "for" and substitute "from"
8105	5	A period should appear after "time to time"
	6	Delete "cost" and substitute "use". Also the period after "need" should be a comma.
	6	Delete "those" and substitute "these"
	23	after "is" insert "the"
	29	delete "Mr. Neapole's comments" insert "Mr. Neapole has commented"
8108	8	delete "applications they get" and substitute "answers they get to their applications"
8109	7	Delete this line and substitute "depending on the severity of trend, there may now be a lesser time"

E R R A T A (Volume 61 cont'd.)

Page	Line	
8109	13	Delete this line and substitute "Boyles indicates, perhaps in the sense of public"
	20	Delete this line and substitute "requested that his line of credit be adjusted downwards."
	27-29	Delete these lines and substitute "which might well be required each year; if at all possible we intend to stay with that line, and to that end keep ourselves in the position where we"
8110	1-3	Delete these lines and substitute "adjustments in monetary policy. Eliminating the time lag to which you referred, I think, is not in the best interest of the country by any"
8112	19	Delete this line and substitute "that we don't act simultaneously because the impact is not"
8115	20	Delete "cannot experience things" and substitute "gain experience"
	22	Delete "suggests" and substitute "aids in"
	23	Delete "we have" and substitute "if we"
8117	3	Delete "attract" and substitute "contract"
8118	5	Delete "that" and substitute "when"
8120	22	Delete "prevent" and substitute "present"
8127	10	Delete this line and substitute "terms of reaction to the constant flow of loan appli-"
8128	21	"rate structure" not "rates structure"
	25	Delete this line and substitute "tie it in any specific fashion to any particular rate"
8139	26	Delete "formal" and substitute "informal"
8140	19	Delete "it is" and substitute "loans are"
	21	Delete "where" and substitute "whether"
8143	3	Delete this line and substitute "continue to locate in such newly"

E R R A T A (Volume 61 cont'd.)

Page	Line	
8145	4	Delete this line and substitute "Perhaps industry has not reached the point at which"
8146	9	Delete this line and substitute "versus population. In 1955 there were 4,246 branches including"
8156	25	Delete "relates to" and substitute "affects the rates on"
8157	21	Delete "basic" and substitute "basis"
8172	29 & 30	Should read "services such as safe keeping, safety deposit boxes, etc, is set by competition from other sources such as trust" and not as presently set out.
8176	16	Delete "of" and substitute "or"
	17	Delete "and so forth"
8180	6-7	Delete these lines and substitute "If we have given you that impression I will say it is"
	13	Delete this line and substitute "Likewise, on the other hand, on the lending rate. One"
	18	Delete this line and substitute "day upon which to make an adjustment. The fact is"
8186	6	Delete "particularly" and substitute "except"
	9	Delete "not"
8189	10	Delete "stated" and substitute "stayed"
8194	9	Delete "advantage" and substitute "disadvantage"
	24	Delete "member" and substitute "number"
8196	15	Insert "would take this into account" after "banks"
	30	"of" not "to"
8198	2	Delete "to selective" and substitute "of selected"
8199	10	Delete "applying" and substitute "supplying"

E R R A T A (Volume 61 cont'd.)

Page	Line	
8206	8	Delete "much" and substitute "monetary"
8209	14	after "less" insert "desirable"
8211	18	add "s" to "fund"
8218	9	Delete "would" and substitute "could"
	14	Delete ", but is only"
	15	As part of sentence add "and" after "definition"
	16	Delete "government" and substitute "governor" with full stop.
	17	Delete "is that" and start new sentence "With respect"
8219	1	Delete whole line
	2	Delete whole line and commence new sentence starting "If you were"
8221	20	"start" not "started"
8223	1-6	Delete these lines and substitute "Once the exceptional circumstances are over, we feel that the logic of it is that this provision should be removed and the Bank of Canada should rely on the cash ratio -- this would put the liquidity ratio back into commission so that it could be used again once it became necessary."
	10-11	Delete these lines and substitute "to 50, ending with the rather bland statement that in the view of the Bank of Canada the liquid asset ratio"
	21-25	Delete these lines and substitute "Now, in their first annual report thereafter, the Bank of Canada -- I don't have that report in front of me, I am quoting from memory on that, and I could almost tell you the page number, but I will not attempt to do so -- they say in words more or less to this"
8224	1	Delete this line and substitute "were one or two other adverbs in there."
	2-3	Delete these lines and substitute "Now, paragraphs 47 and 48 repeat in a somewhat different way more or less the same arguments that"

ERRATA (Volume 61 cont'd.)

Page	Line	
8224	10	Delete this line and substitute "5 percentage points."
	13	Delete this line and substitute "no agreement on the ratio. It might have varied over a"
	14	"12 per cent" not "20 per cent"
	18	Delete this line and substitute "of the effect of monetary policy on the longer"
	27-28	Delete these lines and substitute "asking about how low would the reserves of liquid assets go in the extremity if we didn't have such"
8226	19-20	Delete these lines and substitute "important standing. We do not have an interlocking directorate, but we have several directors in common."
	22	Delete this line and substitute "is concerned, a bank officer is a vice president"
	26-28	Delete these lines and substitute "of the flow of funds, there has been no evidence of this in any connection. The relationship merely protects what had been a life-"
	30	Delete this line and substitute "The goals of this association"
8227	1-2	Delete these lines and substitute "may be several, but we ourselves have no desire to go into the trust company business,"
	4-5	Delete these lines and substitute "field which they can handle very competently and that there is a mutual advantage in their operation and"
8230	20	"holdings" not "ones"
8231	20	Delete "bearing" and substitute "wording"

ROYAL COMMISSION ON BANKING

AND FINANCE

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Hearings held at Ottawa,
Ontario, on Tuesday,
January 15, 1963.

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THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

* Dr. W. A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

- - - - - -

Mr. H. A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

* Absent

Ottawa, Ontario,
Tuesday,
January 15, 1963.

--- At 9.15 A.M. the hearing resumed.

SUBMISSION OF

THE CANADIAN BANKERS' ASSOCIATION

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APPEARANCES

R. D. Mulholland	- Vice-President and General Manager, Bank of Montreal, and President, The Canadian Bankers' Association
W. T. G. Hackett	- Assistant General Manager, Bank of Montreal
T. A. Boyles	- Deputy General Manager, The Bank of Nova Scotia
L. W. Bond	- General Manager, The Mercantile Bank of Canada
Lorenzo Hebert	- Assistant General Manager, La Banque Provinciale du Canada
C. B. Neapole	- General Manager, The Royal Bank of Canada
A. N. McLeod	- Chief Economist, The Toronto-Dominion Bank
S. T. Paton	- General Manager, The Toronto-Dominion Bank
Louis Hebert	- General Manager, Banque Canadienne Nationale
J. P. R. Wadsworth	- Vice-President and General Manager, Canadian Imperial Bank of Commerce

R. W. Shannon	- Associate General Manager, The Royal Bank of Canada
G. A. Griffiths	- Supervisor, International Department, The Bank of Nova Scotia
F. E. Case	- Assistant General Manager, The Royal Bank of Canada
W. D. H. Gardiner	- Assistant General Manager, The Royal Bank of Canada
J. H. Perry	- Executive Director, The Canadian Bankers' Association
T. L. Avison	- General Manager, Investments, Canadian Imperial Bank of Commerce
M. A. Crowe	- Economic Adviser, Canadian Imperial Bank of Commerce
I. D. Macarthur	- Assistant General Manager, The Toronto-Dominion Bank
W. J. Dixon	- Supervisor, Consumer Credit Department, The Bank of Nova Scotia
W. D. Pitts	- Supervisor, Bank Premises Department, Bank of Montreal
C. L. Townend	- Manager, Mortgage Department, The Toronto-Dominion Bank
H. H. Whipp	- Chief Accountant, Canadian Imperial Bank of Commerce
P. Hunkin	- Assistant General Manager, Canadian Imperial Bank of Commerce

W. H. Ruel	- Supervisor, Routine Operations, The Royal Bank of Canada
J. N. Gosselin	- Assistant General Manager, Banque Canadienne Nationale
C. W. Harris	- Secretary, Bank of Montreal
J. C. Lofquist	- Manager, Personal Loan Department, Canadian Imperial Bank of Commerce
J. V. M. Chambers	- Secretary to the Committee.

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THE CHAIRMAN: I call the meeting to order. This morning we will receive a submission from the Canadian Bankers' Association.

I would first like to thank you, Mr. Mulholland, and the other members of the Association here today for the very great assistance you have given to us during the course of the last few months. We have asked you many questions, I hope none of which were embarrassing, and we have always had the fullest and most constructive answers. Of course these questions and answers are indispensable to us in the carrying on of the work of the Commission; had it not been for your co-operation our task would have been next to impossible in dealing with the problems that are involved between the Commission and your Association.

I understand, Mr. Mulholland, you wish to make an opening statement.

MR. MULHOLLAND: If I may, Mr. Chairman, I should like to make a general statement. First, may I say thank you very much for your generous remarks regarding the work that the Canadian Bankers' Association and the chartered banks have done in the past many months. There has been a great deal of work attached to it. It has been intensely interesting for us, and I hope that it provided a most useful contribution to your major task.

Mr. Chairman, the Canadian Bankers' Association welcomes the opportunity of appearing

[illegible] This morning we will [illegible]

than the [illegible] General Assembly [illegible].

I would first [illegible] to thank you, [illegible]

[illegible] and the other members of [illegible]

here today for the very great [illegible]

given to us during the [illegible]

we have asked you many questions [illegible]

which were [illegible], and we have [illegible]

the fullest and most [illegible].

course these questions and answers [illegible]

to us in the [illegible] of the work of the [illegible]

had it not been for your co-operation [illegible]

would have been next to impossible [illegible]

with the problems that [illegible]

Commission and your Assembly [illegible].

[illegible]

wish to make an opening statement.

MR. [illegible]: [illegible]

Chairman, I should like to make [illegible]

First, may I thank you [illegible]

generous terms [illegible]

[illegible]

have done in the past [illegible]

has been a great deal of [illegible]

It has been [illegible]

hope that it provides [illegible]

to your [illegible].

MR. [illegible]

[illegible]

before this Royal Commission and of assisting in your studies of issues which are of greatest concern to us in the banking business and of vital importance to the whole Canadian economy.

This submission was to have been presented to you last July but for reasons with which you are familiar our appearance was postponed. Our brief therefore has been in your hands for some months, and with this in mind I have assumed that you would not wish me to review it in detail at this time. We have reconsidered it fully and carefully in recent weeks, and despite the dramatic developments that have taken place in the last six months have found that we would not wish to change it in any substantial respect. In fact our view is that recent events have only served to provide further evidence in support of the observations and recommendations put forward in our written submission. There have been two or three practical developments in banking in the interim which no doubt will interest the Commission, but these can be left for comment during the course of our testimony.

I need hardly remind the Commission that in any Association of business interests there will be differences of views on many issues, and this is as it should be. Bankers are no exception in this regard, and we have attempted in our brief to present a common recommendation only on matters on which there was general agreement. This point is

[illegible] This Royal Commission and of assisting it in the studies of issues which are of greatest concern to us in the hearing, but are also of vital importance to the whole Canadian society.

This submission was to have been presented to you in early [illegible] the month which you saw [illegible] our Association has postponed. Our brief has been in final form for some months, and [illegible] I have assured that you would not want me to review it in detail at this time. We have [illegible] and carefully in recent weeks, [illegible] despite the dramatic developments [illegible] taken place in the last six months have found nothing that would change it in any substantial respect. In fact our view is that recent events [illegible] have served to provide further evidence in support of the observations and recommendations [illegible] in our written submission. There have been one or three practical developments [illegible] in the interim which we would [illegible] but these can be left for [illegible] the course of our testimony.

I must [illegible] that in any Association [illegible] there will be differences of views on many issues, and [illegible] is as it should be. Farmers are no exception in this respect, and we have attempted in our brief to present a common recommendation [illegible]

[illegible]

brought out in a paragraph in the introductinn, from which I would like to quote:

> " This brief does not pretend to offer definitive answers to all the questions it raises, because these matters carry well into areas where value judgments must be made between alternative objectives and where it would be neither possible nor desirable for the chartered banks as a whole to speak with one voice. Accordingly they have presented a common viewpoint wherever possible, and where specific recommendations are made such recommendations carry the support of the banks generally. On the other hand where there has been a division of opinion on substantial matters the brief acknowledges it and endeavours to summarize the major viewpoints."

As you know, the Executive Council of the Association is comprised of the General Managers of the eight chartered banks and they are all here today with the exception of one who is represented by his Deputy General Manager and another who had to withdraw from the group yesterday owing to a bereavement in the immediate family. All these officers will play an active part in the discussions with you and will carry its main burden. However as we progress

[illegible]ought out in a paragraph in the [illegible]
[illegible], would like to quote:

" This brief does not purport to [illegible] question [illegible] because there would [illegible] judgments must be made [illegible] alternative objectives and where it would be neither possible nor [illegible] for the chartered banks as a group to speak with one voice. Accordingly they have placed on a common [illegible] whenever possible, [illegible] recommendations [illegible] mendations where the [illegible] more generally. [illegible] where there has been [illegible] opinion on [illegible] brief [illegible] summarize the [illegible]

As you know, the [illegible] association is comprised of the [illegible] of the eight chartered banks and [illegible] today with the exception of [illegible] by the Treasury General [illegible] [illegible] in the [illegible] will play an active part [illegible] will carry the [illegible]

subjects may be introduced where it will be desirable to draw on the technical and practical knowledge of senior bank officials who operate in highly specialized areas of banking, and with that in mind we have several such officers in our group -- un groupe imposant!

If there are any matters which are not clearly defined in our brief or in the additional memoranda and statements which have been asked for and readily supplied to the Secretary of the Commission, we shall be only too pleased to supplement the information in the brief or furnish views and statements on subject matters which might arise during the course of the hearing.

Now with your permission, Mr. Chairman, I should like to introduce to you and the other members of the Commission the group gathered at this hearing.

On my immediate right and left, Mr. Hackett and Mr. Boyles, Chairman and Deputy Chairman respectively of the main co-ordinating committee, responsible for the preparation of our brief.

On my far left, Mr. Bond; Mr. Lorenzo Hebert; Mr. Neapole, a Vice-president of the Association; on my far right, Dr. McLeod, Chairman of the bank economists committee. There are three members of that important committee who are not sitting before you: Dr. Galbraith, Mr. Toten and Mrs. Alison Mitchell. Next to Dr. McLeod

[illegible] note may be introduced where it will be desirable to draw on the technical and practical knowledge of senior bank officials who operate in highly specialized areas of banking, and with that in mind we have several such officers in our group -- as group component.

If there are any matters which are not clearly defined in our brief or in the additional memoranda and statements which have been forwarded or not recently supplied to the Secretary of the Commission, we shall be only too pleased to supply the information in the brief or furnish more and statements on subject matters which might arise during the course of the meeting.

[illegible] Mr. Chairman,

I should like to introduce to you and the other members of the Commission the group gathered at this hearing.

On my immediate right and left, Mr. Hackett and Mr. Boyles, Chairman and Deputy Chairman respectively of the main co-ordinating committee responsible for the preparation of the brief.

On my far left Mr. [illegible] Mr. [illegible] Nesbitt; Mr. Meapole, a Vice-president of the Association; on my far right Dr. [illegible] Chairman of the bank economists committee. There are three members of that important committee who are also sitting behind me: [illegible] and Mrs. Alison Mitchell. Next [illegible] Mr. [illegible]

is Mr. Paton; Mr. Louis Hebert; and Mr. Wadsworth, a Vice-president of the Association.

In the second row, from left to right, Mr. Shannon, who has special knowledge of matters in the field of international banking; Mr. Griffiths; Mr. Case; Mr. Gardiner; Mr. Perry, Executive Director of the Association; Mr. Avison, Mr. Crowe; Mr. Macarthur; Mr. Dixon.

In the third row from left to right, Mr. Pitts; Mr. Townend; Mr. Whipp; Mr. Hunkin, Mr. Ruel; Mr. Gosselin; Mr. Harris; Mr. Lofquist and Mr. Chambers.

M. LOUIS HEBERT:

Monsieur le prési dent, en ma qualité de membre du Comité exécutif de l'Association des Banquiers canadiens, il me fait plaisir d'ajouter, en français, quelques mots aux remarques que vient de faire le président, M. Mulholland.

Nous désirons souligner le fait que les banques à charte comptent, tant parmi leurs employés que parmi leurs clients, une proportion importante de Canadiens français qui contribuent ainsi au développement économique du pays.

Nous apprécions toute l'importance de vos travaux et nous ne doutons pas que de vos recommandations découleront des mesures susceptibles de développer le régime bancaire dans le meilleur intérêt de la communauté canadienne.

[illegible], Mr. Fould [illegible] [illegible]

[illegible] of the Association.

In the second row, [illegible] to right,

Mr. [illegible], who has special knowledge of matters in the field of [illegible] [illegible] [illegible] [illegible] [illegible], Director of the Association; Mr. [illegible]; Mr. [illegible] [illegible].

In the third row [illegible]

Mr. [illegible]; Mr. [illegible]; Mr. [illegible]; Mr. [illegible]; Mr. [illegible]; Mr. [illegible]; Mr. [illegible] and Mr. Chambers.

M. [illegible]:

Monsieur le président, [illegible] qu'ancien membre du Comité [illegible] des [illegible] canadiens, [illegible] [illegible] français, quelques mots [illegible] le vice-président, M. [illegible].

Nous [illegible] [illegible] la [illegible] à chaque [illegible] que [illegible] de Canadiens français [illegible] contribuent [illegible] développement économique du pays.

Nous [illegible] [illegible] vos travaux et nous ne [illegible] que les recommandations découlent des [illegible] de développer le régime [illegible] de la communauté canadienne.

THE CHAIRMAN: Thank you, gentlemen.

First I would like to discuss for a few moments the assets of the chartered banks. There are certain paragraphs in your submission, which might be referred to -- 92, 27, 81, 88 and 84 -- which deal in part with certain aspects of the bank assets. It would appear from your submission that the main class of assets which the banks invest in might be referred to as short term of various kinds. I suppose that has been so, and still is so, and with certain exceptions might be called the core of the banking business. Perhaps that is too broad a statement.

Why do the banks confine themselves to such a large extent to this class of asset? Is there any particular underlying reason why this is pecularliarly to the advantage of your type of business?

MR. MULHOLLAND: If your question, Mr. Chairman, relates to lending, or if I might interpret it investments, so far as our lending activity is concerned the short-term priority factor is our short-term loans, loans to businesses, to finance inventory and receivables; this category of lending is the primary role of the banks, and they are the principal financial institutions active in it. Other financial institutions are more interested in the long-term lending field, which is not the first priority of the banks.

The rate of returns on commercial loans will probably be supplemented by other collateral

[illegible]

[illegible]

concerns the [illegible]

certain paragraphs in [illegible]

be referred to - 92, [illegible] and 91 - which

deal in part with [illegible]

It would appear from your [illegible]

class of assets which [illegible]

be referred to [illegible]

suppose that has been [illegible]

[illegible]

banking business. [illegible]

Chairman.

Why [illegible]

to some a large extent [illegible]

there any particular [illegible]

peculiarly to the [illegible]

MR. [illegible]

Chairman, [illegible]

ones in [illegible]

is [illegible]

[illegible]

Inventory and [illegible]

the primary [illegible]

principal financial institutions [illegible]

financial institutions are [illegible]

long-term lending [illegible]

priority of the banks.

[illegible]

[illegible]

revenues, such as foreign exchange and collections. The net profitability of the chartered banks lending in investments is probably greater than for loans at any given rate of interest because of the smaller administrative cost of investments. The classification of lending that I have described as having priority, which is the short-term lending to business, is most appropriate to banks and is peculiar to the banking system.

THE CHAIRMAN: When you speak of the cost of loans, that applies to commercial loans as well as to personal loans? There are services involved that are not applicable to the ordinary investments, I take it?

MR. MULHOLLAND: Yes, Mr. Chairman.

COMMISSIONER LEMAN: May I ask a question to clarify this point?

Did I understand you to say, Mr. Mulholland, that in general the yield on your investments, after taking costs into account, would be higher than the yield on loans?

MR. MULHOLLAND: Yes, Mr. Leman. There are a great deal more costs attached to making loans to business or to individuals than there would be for the banks to place their resources in investments which require very little policing; they are of a prime nature and are not considered to be of a major risk. The major risk of the banks are loans to business and to individuals.

COMMISSIONER LEMAN: Is it the practice

of the banks to actually do cost accounting on the various classes of assets they hold?

MR. MULHOLLAND: We do to a limited extent, but it is very difficult to set to one side one group of loans -- for instance, loans to large corporations or loans to small businesses, or loans to individuals -- and it is very difficult to departmentalize these loans in relation to revenues and expenses, because the management and staff at any given branch are involved in many things in the course of a day. It would be quite a difficult task to, for instance, divide up the manager's time into fractions and endeavour to apply a fraction of his time to one class of business.

COMMISSIONER LEMAN: I was wondering what costs you would ascribe to loans that you would not charge to the running of the branch. The existence of a branch is to gather money from the public, first and foremost, is it not?

MR. MULHOLLAND: Yes, that is its first task.

COMMISSIONER LEMAN: I was surprised by the statement that necessarily the cost of loaning would lower the yield so much as to bring it below the average yield on investments.

COMMISSIONER BROWN: Why would a bank ever sell an investment to make a loan if the investment is more profitable?

MR. MULHOLLAND: In that area, Mr. Brown, we do have a responsibility in the chartered

[illegible] the

[illegible]

MR. CHURCHMAN: [illegible]

extent, [illegible] is very difficult to get [illegible] with any group of [illegible], seems to [illegible] [illegible] classified, or [illegible] difficult [illegible] [illegible] because the [illegible] going through [illegible] in the [illegible] quite a difficult task, to, [illegible] up the magazine [illegible] question and [illegible] [illegible]

CHAIRMAN [illegible]: [illegible]

[illegible]

[illegible]

MR. MCCLELLAN: Yes, [illegible]

[illegible].

CHAIRMAN [illegible]: I [illegible]

by the [illegible] [illegible]

[illegible]

MR. [illegible]: [illegible]

banks not only to take and safeguard deposits, but also to make loans to individuals and business. If we do not discharge that second responsibility, I venture to say we would shortly be without deposits. The two go together: you are providing an additional service to depositors, putting it very broadly, by making available to the individual or the company credit-worthy loans as required.

THE CHAIRMAN: In order to obtain the money to put into investment, you have to attract deposits?

MR. MULHOLLAND: Right, sir.

THE CHAIRMAN: And a good deal of your costs arise in the operation of attracting deposits, is that not so?

MR. MULHOLLAND: That is right, sir.

THE CHAIRMAN: Branch offices and many other items of expense are necessary to keep the deposits up to the level which you desire. You take that into consideratinn when you compare the costs of loans and investments?

MR. MULHOLLAND: Yes. It is the cost of gathering funds for our lending operations.

COMMISSIONER LEMAN: Excuse me, Mr. Chairman. The Secretary has just called my attention to a point I may have missed in Mr. Mulholland's statement.

Did you say that at a given gross yield the returns are lower on loans than on similar investments that would have the same gross yield?

You did not say that in the absolute at all times the yield on investments was higher than the net yield on loans?

MR. MULHOLLAND: No. It is essentially right to say that revenues from investments provide a better yield than revenues from loans. This is due not to the lack of supervision on our investment portfolio, but the very much lower cost of supervision of investment portfolio.

COMMISSIONER BROWN: As I wrote down what you said, it was that the net profitability on investments was probably greater than for loans. I think Mr. Leman's question is, what costing are you putting against this to get that statement?

MR. HACKETT: It has been suggested, Mr. Brown, that I perhaps say a word about this from the investment side.

As to the supervising of a very large investment portfolio, predominantly in Government of Canada securities, it may be supervised from a central office; you would not need the wide network of supervision that you need for administration of a loan portfolio.

With respect to the profitability factor, I think there is this to be said that in a static situation your net revenues on a costing basis, for the reasons that I have stated, may be and indeed are greater than revenues from a thoroughly costed loan operation.

Situations do arise where, in order to maintain any given loan volume, investments may have to be sold. Those sales usually occur when monetary conditions are becoming tighter and it follows then that these investments are sold on a falling market and may involve, and indeed do involve from time to time, considerable losses, not in revenue return but in market losses that arise out of the sale of securities.

Other situations arise when absolutely -- I am bound to say the situations do not arise very frequently -- the gross yield even on a Government of Canada bond may be very nearly comparable and indeed may exceed the average overall revenue from a loan portfolio. However, I think the point is that in those circumstances the banks do not stop lending money when from a sheer profitability standpoint it might be advantageous to do so.

They do feel that their first priority is to look after the lending needs, that is the first priority on the side of the deployment of assets is to look after the lending requirements of the community. In that process they are willing at times to take substantial losses through the sales of investments.

COMMISSIONER LEMAN: I consider this an extremely important point. I should like to pursue it a little bit. Do you mention this as just a fact or do the banks consider this normal? You see, what I have in mind is that the banks have been operating under legislation which limited the yield of loans to 6 per

cent, by law. This may have had some effect in producing this result that you point out to us.

MR. HACKETT: Well, Mr. Leman, I do not quite know what significance to give the word "normal". I think this can be said that a set of situations in which you have to sell investments, sometimes in very large volume, does occur, and in recent years in response to the swings of monetary policy they seem to have occurred with somewhat greater frequency than in the past.

COMMISSIONER LEMAN: But, Mr. Hackett, this occurs only because the banks consider their primary purpose is to make loans. It only occurs for that reason. Monetary conditions would not force you to sell investments for the purpose of making loans.

MR. HACKETT: I think that is so, sir. I think the banks regard their primary responsibility on the asset side as that of looking after the lending requirements of the Canadian public. In that sense your investment portfolio becomes, in certain circumstances, a residual within certain practical limits.

COMMISSIONER BROWN: I think this is the important point, is it not?

MR. HACKETT: Yes.

COMMISSIONER BROWN: Your operations that are designed to be attractive to deposits are also geared to make your loans. You are not wearing a halo and suggesting that your loans are loss-leaders, surely.

MR. WADSWORTH: I think it is fair to say we look upon our investment portfolio as complementing

[illegible]

MR. [illegible]: Well, Mr. [illegible] [illegible]

[illegible] "savings". I [illegible] you have to sell Government [illegible] in very large volumes, [illegible] in recent years in response to the [illegible] of monetary policy they [illegible]

COMMISSIONER [illegible]: [illegible], Mr. [illegible], this occurs only because [illegible] their primary purpose is to make loans. [illegible] for this reason. [illegible] sell investments for the purpose of making loans.

MR. [illegible]: I think that is so, [illegible] I think the banks [illegible] responsibility [illegible] suggest also as that of looking after the lending requirements of the [illegible]. [illegible] their investment [illegible]

(COMMISSIONER [illegible]: I [illegible] is the important point, [illegible])

MR. [illegible]: Yes.

COMMISSIONER [illegible]: [illegible] that are [illegible]

MR. [illegible]: I [illegible]

[illegible]

to a degree our lending operations. In the first place we have to maintain a certain degree of, you might say, extreme liquidity for fluctuations in deposits, but when we leave that and get into what we consider one of our prime functions in supplying short-term working capital loans to individuals, then our investment policy is something that complements the loan policy.

COMMISSIONER BROWN: Could we ask if any of the other general managers have any comments to add to this?

MR. NEAPOLE: My comments would be the same as those of Mr. Wadsworth. We do regard our prime functions as making loans and our investment policy becomes complementary to it. There is no question about that.

THE CHAIRMAN: Regarding that as your prime function, that is the choice that you have made, is it not?

MR. NEAPOLE: It is the way the system has grown from the beginning.

THE CHAIRMAN: It is the way it has grown. Why do you favour the short-term loans in the course of your business?

MR. NEAPOLE: It is a question of making the money do the most good for the most people. The average person's day-to-day requirements are of a short-term nature in business. By staying in the short-term mostly, as I said before, we can make the most money do the most good for the most people.

THE CHAIRMAN: And it is in that line of business that you have developed your special expertase as commercial banks?

MR. NEAPOLE: That is right. In the history of the country it had to be that way.

COMMISSIONER BROWN: It is not related to the shortness, the liquidity of your liabilities?

MR. NEAPOLE: Oh, yes, it is to some extent, but on the average the requirements of the country at large are of a short-term nature, that is, the day-to day requirements of business, the financing of inventories, the receivables, and so forth.

COMMISSIONER LEMAN: Could we look for a second at page 135? There you show that the gross yield on securities as against the gross yield on loans -- those are gross yields, are they not, at the bottom of the table?

MR. MULHOLLAND: Yes, they are, Mr. Leman.

COMMISSIONER LEMAN: That is why I asked you the question in the way I did. I was using the word "normal" in the sense of over time. Is it always true that after proper costing you would consider the return on loans lower than the returns on securities? There are certain areas there where the yield is quite high. Would one have to imply therefore, that, let us say, in 1945, the cost of administering loans was more than the difference in the gross yield?

MR. MULHOLLAND: I would say that in 1945, Mr. Leman, the low rates of return on investments, very low rates of returns prevailing in those years, as I

recall it, would have a bearing on that low gross return.

COMMISSIONER LEMAN: Could we think of the year 1945 as perhaps a year where the net profitability on loans may have been higher than on investments?

MR. MULHOLLAND: Yes. The answer to that would be yes.

COMMISSIONER LEMAN: It was in that sense I was using the word "normal". Do you think that over a long period the statement would be true that the net yield on loans would be lower than on investments, over the long run?

MR. MULHOLLAND: My answer to that, Mr. Leman, would be that over the long run it would average out.

COMMISSIONER LEMAN: To be about equal?

MR. MULHOLLAND: To be about equal.

MR. WADSWORTH: May I add a further comment?

THE CHAIRMAN: Yes.

MR. WADSWORTH: I should like to return to what I said a moment ago about the fact that we regard investments, apart from that short-term liquidity, as something complementing our lending policy. We have already said we regard supplying short-term working capital as one of our prime requirements. So, to answer your question, if it can be answered in a general way, if investment policy was not complementing our lending policy, it would probably follow that we would pursue a different investment policy and a different composition of our portfolio.

We do not regard ourselves as being just an

result in, would have a [illegible] on that low gross return.

COMMISSIONER LEMAN: Could we think of the year 1949 as perhaps a year when the net profitability on loans may have been higher than on investments?

MR. [illegible]: Yes. The answer to that would be yes.

COMMISSIONER LEMAN: It was in that sense I was using the word "normal". Do you think that over a long period the statement would be true that the net yield on loans would be lower than on investments, over the long run?

MR. [illegible]: My answer to that, Mr. Leman, would be that over the long run it would average out.

COMMISSIONER LEMAN: It would about equal?

MR. [illegible]: To be about equal.

MR. [illegible]: May I add a further comment?

THE CHAIRMAN: Yes.

MR. [illegible]: I would like to return to what I said a moment ago about the fact that we regard investments, apart from that short-term liquidity, as something complementing our lending policy. We have [illegible] until we regard anything that [illegible] working capital as one of our prime requirements. So, to answer your question, it is, [illegible] it, a general way, if investment policy was not complementing our lending policy, we would probably think that we should pursue a different investment policy and a different composition of our portfolio.

We do not regard our role as being just an

investment insitution for savings, so that our yields on investments are often influenced by our lending requirements or our anticipated lending requirements and the shortness or length of our portfolio.

THE CHAIRMAN: From that do we draw the inference that if you had not chosen as your main line of business extending loans, you would have been free to have entered into a greater degree long-term investments which would yield more?

MR. WADSWORTH: I would suggest, Mr. Chairman, with all respect, that in that way we would not have been performing our banking functions.

THE CHAIRMAN: I suppose it is purely a hypothetical question in view of the type of business that you carry on, but it is also true, is it not, that if you were not carrying on functions of banking as you have described them you might have been in quite a different position with respect to your ability to attract deposits and to attract funds for investments?

MR. WADSWORTH: With respect to certain types of deposits I would agree, we would have become probably more of a specialized institution rather than providing a broad banking service, and I would think that some other form or something else would have found its place in the financial economy to take the place we had vacated.

THE CHAIRMAN: I think in some other part of your submission you have entered into discussion of the banking business and you regard the banking business as being one primarily concerned with short-term

securities, the banking business as you carry it on. I get the impression you regard that as being peculiar to banking, that a business which engages in long-term investments primarily is outside the scope of what is ordinarily known as banking. Is that the way you regard it?

MR. MULHOLLAND: Yes, that would be a fair definition.

THE CHAIRMAN: So, you would distinguish your type of business from the ordinary savings bank type of business, would you, -- that is, a bank known as a savings bank which does not deal in the sort of short-term business that you do?

MR. MULHOLLAND: Other financial intermediaries, Mr. Chairman, acquire or attract deposits on longer term. Therefore, they are more interested in and their primary objective is to invest those funds coming to them in longer term loans or investments. The savings deposits in banks follow a chequing basis and they are very definitely on a demand basis. There is a time feature attached to them, but they are considered, and quite often so, as on a demand basis, and therefore, those deposits must be used with care primarily on a short-term basis.

MR. LORENZO HEBERT: May I add something?

THE CHAIRMAN: Yes, certainly.

MR. LORENZO HEBERT: There is a very definite need in our modern economy for working capital. Ever since we had the industrial revolution, the needs of modern industry for working capital have not been the same

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

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[illegible]

[illegible]

from day to day or even from month to month or year to year. There are ups and downs in every kind of business.

The banks, of course, were created after that industrial revolution, just to supply these very particular needs of our modern industry. So, the prime function of the bank is to supply that. The banks were created and developed in that sense, and we have branches which enable us to collect the necessary capital savings, and that is why the prime function of the bank is to serve those needs, and our portfolio, of course, is just ancilliary to that.

On some kinds of investments the cost of operations are so low that they will probably be more profitable than on some loans where the costs are so high, but for the last few years, of course, there has not been much difference between the net yield on investment of loans, but in 1945, when the policy of the government was to have low interest on bonds, well, the net yield on our loans was higher than on the investments.

I do not know whether I make myself clear or not.

THE CHAIRMAN: Yes, I have got a pretty clear idea now of what you have in mind.

COMMISSIONER LEMAN: On the last point, Mr. Mulholland, that you made: this view that you have on liquidity is a particular requirement that each bank has to keep its eye on, because the deposits in the banking system as a whole have never gone down and cannot very well go down, can they?

MR. MULHOLLAND: No, that is true.

COMMISSIONER LEMAN: So that theoretically, if there was one big chartered bank it would not have to have the same attitude towards this liquidity problem, would it? It cannot lose deposits. If someone withdraws a deposit, somebody else puts it right back in, doesn't he?

MR. HACKETT: Perhaps I could say a word on that, Mr. Leman. I would not say that the deposits in the system as a whole could never go down. On occasion they have gone down. There was an occasion several months ago, quite recently, when they went down rather significantly, but that is after all a minor point. I think that from the practical aspects of the problem, these situations of choice arise when your deposits for the system as a whole are, as you suggest, stable, but where for one reason or another there is a sustained upward demand for loans, the framework is only so large and then we are faced with the problem of deploying our assets within our stable framework.

It is at points such as those that the question of what priorities we give to the various types of assets we may acquire enters into this in a very practical way.

COMMISSIONER BROWN: While we are taking that reply in the context of the previous discussion about investments when there was a strong loan demand, you are implying it is a less profitable time for the banks than when they are able to invest in securities?

MR. HACKETT: When there is a strong loan demand a number of things happen, Mr. Brown. You get a different asset mix. When there is a strong loan demand bond prices decline and current yield on bonds, as we know, arise substantially, and that is precisely the time when the banks cannot in the aggregate be buyers of securities, they are more likely to be sellers. This is not a matter of comparative yield or comparative advantage on a yield basis; banks are letting their loan portfolios run down in order to accommodate the loan demand.

THE CHAIRMAN: Security portfolios?

MR. HACKETT: I beg your pardon, security portfolios; letting their investment portfolios run down -- if I could correct that for the record -- in order to accommodate loan demands.

COMMISSIONER BROWN: But was that my question?

MR. HACKETT: I do hope so, sir! Perhaps we could have another try.

COMMISSIONER BROWN: In the context of the previous discussion in which this business about the profitability of investments and profitability of loans

it is at present such as to be that the question of what priorities we give to the various types of assets we may acquire enters into this in a very practical way.

CONGRESSMAN PATMAN: While we are talking that, reply in the context of the previous discussion about investments when there was a strong loan demand you are implying it is a less profitable time for the banks than when they are able to invest in securities?

MR. MARTIN: When there is a strong loan demand a number of things happen, Mr. Patman. You get a different asset mix. When there is a strong loan demand loan prices decline and current yield on bonds, as we know, advance substantially, and that is precisely the time when the banks' profit is the greatest in terms of percentages, that the banks are likely to be ... that is to say a number of comparative yields on competitive investments on a yield basis; banks are letting their loan portfolios run down in order to accommodate the loan demand.

MR. [illegible]: I beg your pardon, Secondly portfolios, letting their investment portfolios run down -- if I could correct that for the record -- in order to accommodate loan demands.

CONGRESSMAN PATMAN: And that was what my question was.

MR. MARTIN: I do, too, sir. Perhaps we could have another try.

CONGRESSMAN PATMAN: In the context of the previous discussion in which this question about the

came up, I asked if in view of that was the banking operation more profitable or less profitable when there was strong demand for loans; that was the question.

MR. HACKETT: I think, sir, there are other considerations which get into that; there is the matter of the asset mix and from the profitability standpoint, and this is a distinction which I would like to introduce here; the loss you take on the sale of securities is a deduction from your profits for that year.

COMMISSIONER BROWN: I understand that, Mr. Hackett, but I am merely asking which is the more profitable set of operations for a chartered bank?

MR. WADSWORTH: May I say a word? I think, broadly speaking, when bank loan ratios are higher -- and I am speaking in the broadest sense -- the operation from the earnings point of view is certainly better because when you have a low loan demand you probably have a low yield on investments at the same time.

I think there are certain cases and at certain times other circumstances that work into it. This, as you know, is covered in our brief, but the competition factor and the time when the loan demand is high -- probably the competition for deposits is high -- banks have been up against the question of the interest rate ceilings and things like that, but I think that the broad answer to your question, in my opinion, would be yes.

COMMISSIONER BROWN: That is what I wanted.

THE CHAIRMAN: There are considerable fluctuations in loans, in the total bank loans from time

came up, I asked [illegible] of [illegible] the banking operation more profitable [illegible] profitable area was [illegible], [illegible] for [illegible]; [illegible] was the question.

MR. [illegible]: I [illegible], sir, there are other considerations [illegible] get into that; there is the matter of the asset [illegible] on the [illegible] by [illegible], and [illegible] consideration [illegible] I would like to [illegible] [illegible] the loss you take on the sale of securities is a deduction from your profits for that year.

[illegible]: I understand that, Mr. Hackett, but I am merely asking which is the more profitable set of operations [illegible] [illegible]?

MR. WADSWORTH: May I say a word? I think, broadly speaking, when [illegible] rates are higher -- and I am speaking in the broadest sense -- the operation from the earnings point of view, is certainly better because when you have a low [illegible] you probably have a low yield on investments at the same time.

I think there are contrary cases, and at certain times other circumstances that work into it. That, as you know, is covered in [illegible], but the [illegible] factor and the time when the [illegible] is high -- probably the [illegible] is high -- we have been up against the [illegible] of the [illegible] [illegible] and [illegible], I think that [illegible] [illegible], to your question, I [illegible], would be [illegible].

[illegible]

[illegible]

[illegible]

to time, I assume. It seems to me that I have seen the figures on that.

COMMISSIONER BROWN: It comes out very clearly on the figures on page 135.

COMMISSIONER LEMAN: I am interested in this subject. I think it was pointed out earlier that the banks also have got not only this distiction between investments and loans but also consider that the main function is to make short-term loans, working capital loans, but are these loans in fact very short term? The fact that they are perhaps demand loans makes them really short term because of the contract arrangements with the customer, but do they in fact not stay on the bank's books for a long period of time?

MR. NEAPOLE: The answer is yes to both questions. There is no question about it that in the revolving type of lending operations the loans to customers might be more or less the same figure for quite a length of time. It will fluctuate in some degree, but it is probably more the common case now than it used to be, simply because I think business in Canada is less seasonal in many ways than it used to be.

For instance, lumber operations are carried on all summer as well as all winter, so that you may not have the seasonal payout from that type of operation. On the other hand, the level might be lower instead of the peaks. You will have cases where there are definite seasonal operations, such as canning vegetables or something like that, or canning fish, where you do

have a definite payout on your loans from time to time, but on the other hand -- provided business is going in a logical pattern -- we regard that as being, let us say, not the equivalent of a payout, but certainly a satisfactory trend as far as the balance is concerned in our appraisal of the account.

THE CHAIRMAN: Does it make any difference to you whether you loan money, knowing that every six months or so you will renew the loan, which was given for the purpose of some construction project, or something that necessarily would be a long-term business, as distinct from the sort of loans that you have described for working capital? There is a revolving revolution in it.

MR. NEAPOLE: When we make a loan for a construction project, as a rule it is made against a definite payout of some description.

THE CHAIRMAN: Yes, but on various occasions you will renew that loan?

MR. NEAPOLE: That is true.

THE CHAIRMAN: Is there any policy as to the limits within which you renew loans of that kind?

MR. NEAPOLE: There again, so much depends on your original arrangement with the customer. As a rule, as I said, there is definite payout in sight, either from earnings or perhaps from a mortgage or capital financing of some description.

Now, in some cases the customer will come back to us after a period of six months or a year, or something, and say that the cost of capital borrowing

bring a definite period of [illegible]

but on the other hand [illegible]

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not the end [illegible]

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your [illegible] of the [illegible]

THE CHAIRMAN: [illegible]

to you whatever [illegible]

months or no one will renew the [illegible]

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something that necessarily would be a [illegible]

business, as distinct from the [illegible]

have described for [illegible]

revolution in it.

MR. [illegible]: [illegible]

construction project [illegible]

definite period of [illegible]

THE CHAIRMAN: Yes, [illegible]

you will renew that [illegible]

MR. [illegible]: [illegible]

THE CHAIRMAN: Is there any [illegible]

the limits within which you [illegible]

MR. [illegible]: [illegible]

in your original [illegible]

rule, as I said, there is [illegible]

either from [illegible]

certain [illegible] of some [illegible]

Now, [illegible]

back to [illegible]

is too high right now, could he carry it for another six months or something of that kind, but we do have to deal with that, I am safe in saying. The other general managers may say something about this, too, but we do have to deal with each situation as we see it.

I couldn't say that we have a definite policy on a thing of that kind, unless it may become too prevalent and then we would try to make certain that they did go to the capital market.

THE CHAIRMAN: You do not regard loans of that kind as one of the prime features of your business?

MR. NEAPOLE: I would say that they are relatively small in relation to the total of our loaning operations.

THE CHAIRMAN: It would mostly be, if loans are renewed, they would be of a revolving nature to deal with any situations as they arise.

MR. NEAPOLE: Usually, yes.

THE CHAIRMAN: You have suggested in your brief that the general prohibition on mortgage lending should be removed. You have in mind, apparently, engaging to a greater extent than you have in mortgage lending?

MR. NEAPOLE: Well, sir, I am sure this is something in which the different banks will perhaps disagree. Certainly as far as my own bank is concerned we do not look upon it as being anything more than a permissive feature. We haven't thought of going out into big commercial mortgages, or anything of that kind. I think we all feel -- and I think I am safe in saying

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ask [illegible]

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MR. [illegible]

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resolution.

MR. [illegible]

are removed, [illegible]

with any [illegible]

MR. [illegible]

MR. [illegible]

rather than [illegible]

should be removed, [illegible]

[illegible]

language?

MR. [illegible]

something [illegible]

language. [illegible]

we do [illegible]

paragraph [illegible]

and the [illegible]

this -- we all feel that there should be a permissive feature there to meet competition of one kind or another.

THE CHAIRMAN: You don't visualize that as a large part of your future business?

MR. NEAPOLE: Well, I wouldn't.

THE CHAIRMAN: Or do you?

MR. NEAPOLE: No, I wouldn't myself.

THE CHAIRMAN: But it is the sort of business that requires a certain type of employee and staff who can service that sort of loan?

MR. NEAPOLE: Yes, it would.

THE CHAIRMAN: And unless you get into that sort of a business on a reasonably large scale it might be quite costly?

MR. NEAPOLE: I suppose it could be, but I would think that we would seek advice; if we didn't have the people who were qualified, I think we would seek advice from people who were qualified under the various properties, for instance, if they were offered on a mortgage basis.

THE CHAIRMAN: But apparently you don't take the position that mortgage lending is peculiarly the preserve of mortgage companies and trust companies who engage in that sort of business in a regular way?

MR. NEAPOLE: Well, certainly they do engage in that kind of business and we don't suggest that it should be enlarged as far as I am concerned any more than a permissive type of thing.

MR. WADSWORTH: May I comment further? I

think one of the answers to one of your questions was the response of the banks and what they did in the National Housing Act field when they obtained permission in 1954. There have been several contributing factors, as you know, since the ceiling was put on the interest rate and where we have had periods of monetary stringency, but the banks did get into the field in a relatively large way. We set up departments and many of us have, I think, experienced mortgage departments now as result of our experience in that area, so I wouldn't look for any real problems that the banks couldn't solve with their present set-up, and probably some additions, in handling mortgages of a conventional nature.

There probably is some degree of difference between the opinions of some of the banks, as Mr. Neapole says, as to the entry into this field. I think a number of us feel that this is another financial service that the public is looking for and that we should, as he said, have permission to enter this field, subject to many factors such as monetary policy and supply of money and the composition of our other assets.

THE CHAIRMAN: Is the reason why you have discontinued in this field the 6 per cent ceiling?

MR. WADSWORTH: It has been a major contributing factor. There have been short periods of quite tight money, as you know, where I think under any circumstances we would be curtailed to a degree at least. When the going rate was 6-3/4 per cent -- it is now 6½ per cent -- it just would not have

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The CHAIRMAN. [illegible]

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Mr. [illegible]

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been practical for the banks to be lending at the same time at 6 per cent.

THE CHAIRMAN: Originally you were invited to go into the mortgage field, as I recall it, I think that is what happened, what is not?

MR. WADSWORTH: I think that is fair.

THE CHAIRMAN: It was moral suasion?

MR. WADSWORTH: "Invited" I think is better.

THE CHAIRMAN: You went into it somewhat reluctantly at first, or had you had this sort of business in mind before the invitation?

MR. WADSWORTH: No, I think we actually used the word "reluctance" in the brief in one section of it. I think probably it would be just as fair to say that we were feeling our way. We had to set up an organization, we had to really start from scratch into a field and a service we had not provided. Once we became organized and moved into it, I think it would be fair to say that the competition factor had quite a bearing because banks do not move necessarily together, and yet if one bank is moving more strongly, more aggressively in an area up to a point, I think it follows that other banks from their own competitive point of view would take action too.

THE CHAIRMAN: Well, those who went into it apparently regarded it as an appropriate business from the point of view of banks?

MR. WADSWORTH: We did.

THE CHAIRMAN: And saw that it was sufficiently lucrative to be worthwhile expanding, is that the

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that [illegible].

THE CHAIRMAN: [illegible]

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MR. WADSWORTH: I [illegible]

THE CHAIRMAN: [illegible]

MR. WADSWORTH: [illegible]

THE CHAIRMAN: [illegible]

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THE CHAIRMAN: Well, [illegible]

[illegible]

from the point of view [illegible]

MR. WADSWORTH: [illegible]

THE CHAIRMAN: [illegible]

situation?

MR. WADSWORTH: That is right.

MR. NEAPOLE: May I make a remark, please? There are other things in connection with mortgage lending -- and this is through the chartered banks -- and one is that they reach all these small places which very frequently the larger types of mortgage lenders do not, so that there would be cases where quite deserving people looking for mortgage money in a smaller community would not have access, let us say, to one of the larger mortgage lenders except at some cost or inconvenience, and all the rest of it.

THE CHAIRMAN: And, of course, you have your local branches?

MR. NEAPOLE: That is right.

THE CHAIRMAN: Which facilitates the business in that respect?

MR. NEAPOLE: Correct.

COMMISSIONER BROWN: There are two possible intermediate steps, two possible stages or different ways of looking at it. One is if things were thrown open so that you could go into any kind of mortgages, and the other one was if you could specifically go into NHA mortgages regardless of the ceiling on interest rates?

MR. NEAPOLE: Yes.

COMMISSIONER BROWN: Would you take on NHA mortgages at the present level, at 6½ per cent?

MR. NEAPOLE: I think that is a question for each individual bank to answer, really. At the 6½ per

cent it is just possible that we would, but I don't know; it would depend on our situation, how our funds were moving.

MR. MULHOLLAND: May I contribute something here? The answer, as I see it at the present time, is that the banks are very fully loaned up. Their primary responsibility is for current loans for working capital purposes and this might not be the particular time when the banks as a group would be enthusiastic about going into $6\frac{1}{2}$ per cent mortgages, but in between when the resources are a little more fluid they could have an opportunity to play their part in taking a share of NHA loans, and then could be shut out of that market when they are able to be of assistance to it.

COMMISSIONER LEMAN: But do you believe that the banks would be essentially "in and outers" in that market?

MR. MULHOLLAND: In the conventional mortgage field, or the N.H.A. mortgage field?

COMMISSIONER LEMAN: Let us take the N.H.A. mortgage field first.

MR. MULHOLLAND: With respect to the conventional market I think it is fair to say that the banks have been in and out, either because of difficulty as a matter of monetary policy or a shortage of lending resources, or because of the rate of interest. I think, given the permissive legislation to go into the conventional mortgage market, the only limitation would be a shortage of lending resources at any given time. The banks would probably have to draw back a bit from that conventional market in times of shortage of money, but there are many other lending intermediaries who might still be able to carry on in that market. Indeed, it has been proved that during difficult times they have been able to carry on. I am referring, of course, to the life insurance companies and the mortgage companies, principally. Their primary role in their lending activities might be said to be somewhat in that field, whereas ours would not be.

MR. WADSWORTH: Might I add a further comment on this? I think it would be fair to say that the banks would not wish to be "inners and outers"

[illegible]

the banks [illegible]

[illegible]

MR. [illegible]

[illegible]

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MR. [illegible] problems [illegible] banks [illegible] difficulty [illegible] shortage of lending [illegible] rate of interest. [illegible] legislation [illegible] market. The only [illegible] of lending [illegible] would probably [illegible] but there are [illegible] might still [illegible] Indeed, if [illegible] times [illegible] interest of [illegible]

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MR. [illegible]

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in either the N.H.A. or the conventional field. I think it would also be fair to say that if it is felt by the monetary authorities -- and I would like to feel it is that way -- that the banks were playing a significant role in the conventional field, whether it is in providing competition or in assisting in keeping rates at reasonable levels, that in establishing monetary policy they would probably take this matter into consideration. I cannot answer for them, but I think, as it became evident that we were providing a service that was needed and required, consideration would probably be given to that.

It is also fair to say, I think, that in the conventional mortgage field, even more so than in the case of the N.H.A. mortgage field -- N.H.A. mortgages, as you know, are generally on an amortized basis -- when the banks have built up a reasonable portfolio there would be quite a cash flow for re-investment, even if the monetary authorities were not allowing any particular increase at that time. I think that once we became established in the field and could prove what we were providing what we think is an important service in that area, then we could probably carry on, generally speaking, without too much of the "in and out" to which you referred -- at least, I would hope we could.

COMMISSIONER LEMAN: Which runs a little bit against the earlier view you gave which was to the effect that there is a high demand for business and personal loans, and the banks tend to

satisfy that demand and sacrifice everything else.

MR. WADSWORTH: No, I would not want to leave that impression. I think it would still be primarily in our minds, and that is why I said that a lot would depend on several factors, one of which would be the policy being followed by the monetary authority, or the central bank, in so far as total bank assets were concerned.

If there was any question of having to choose between the two, and if the banks had not built up a portfolio and did not have the cash flow, then I think we would be looking to the short-term requirements of productive business and to any other areas that did not have other sources of funds to turn to.

THE CHAIRMAN: I notice in the statement I have here of bank assets, which is dated March 31, 1962, that the N.H.A. mortgages at that time stood at $939 million; personal loans were $1.483 billion; business loans, $3.769 billion; institutional loans, $206 million; farm loans, $443 million; C.S.B. loans, $257 million; personal loans, $126 million; grain dealers, $287 million; municipal loans, $344 million and provincial loans, $14 million. That gives an idea of the outstanding N.H.A. mortgages at the present time pretty closely in relation to other loans -- the loans of the banks generally.

COMMISSIONER LEMAN: I would like to draw a parallel there. In paragraph 91 of your sub-

mission you point to the lack of enthusiasm on the part of the banks for corporate securities, which you seem to consider as part of an investment portfolio and not part of a loan function. You point to the lack of marketability. Would that be true generally of mortgage loans? Are you not enthusiastic about them because they lack marketability?

MR. WADSWORTH: I think, to a degree, if I may answer you, Mr. Leman, it would be true to say that, although I think, as you know, a considerable amount of study and work has already been done on the development of secondary markets for N.H.A. loans. There is still, probably, a lot to be done in that area. There are some technical problems to be solved, and special corporations have been formed. I would think in due course, with the work that has already been done -- I think you have been given evidence to this effect by others -- that a secondary market for N.H.A. loans will develop. There is a partial one now, but it will develop to a much further degree.

Whether or not there would be a secondary market for conventional mortgage loans, I think, remains to be seen. There, again, I think they are actually for a shorter term than the N.H.A. loans, and I think the cash throw-off through amortization would be relatively greater. I think any bank would need to watch the percentages of its long-term portfolio or its assets that were in that particular field.

[illegible] you wish to [illegible] part of one [illegible] you then [illegible] [illegible] and [illegible] to the [illegible] generally [illegible] about [illegible] because [illegible]

MR. WASHBURN: [illegible] If I may answer you, Mr. [illegible], I would [illegible] to say that, although I [illegible] considerable amount of study [illegible] done on the [illegible] of [illegible] small loans. [illegible] be done in that area. There [illegible] problems to be solved, and [illegible] have been [illegible]. I would [illegible] with the work that has already been done -- I think you have seen [illegible] evidence [illegible] effect [illegible] that a secondary market [illegible] there is a partial [illegible] much further degree.

[illegible] secondary market [illegible] I think, remains to be [illegible] think they are [illegible] the [illegible] through [illegible] I think [illegible] of its long-term [illegible]

COMMISSIONER LEMAN: Is it not true to say that entry into the mortgage market would tend to lengthen the average term of your loans?

MR. WADSWORTH: I think that is quite a fair statement. On the other hand, as we have said, there is within our deposits, taken generally, a hard core of such deposits. It is true that they are repayable on demand, or on a very short-term notice which is never required, but while there are movements between accounts in some areas there is not too much of that in the savings field. There is a hard core that, generally speaking, in total is not subject to very wide fluctuation.

COMMISSIONER LEMAN: That is what I am trying to get at. What is the fundamental objection to a lengthening of the average term of your loans?

MR. WADSWORTH: I do not think there is, in my opinion, any fundamental objection, subject to the judgment of each bank. I think we have some relatively good judges in the management of our assets and as to the composition of our asset portfolios, and as to how far they should go at any one time.

COMMISSIONER LEMAN: Do you think that entry into the conventional mortgage market by the banks would contribute to the development of a secondary market?

MR. WADSWORTH: In the conventional mortgage field?

COMMISSIONER LEMAN: Both conventional and N.H.A.

MR. WADSWORTH: Well, we are in, or we were in, the N.H.A. field, and as I think I said before we would still probably be in it to some extent now if it had not been for the fact of the ceiling on the interest rate that applies to bank loans.

As to the N.H.A. area I would presume the more lenders that are in it the more we would probably be a contributing factor to those who were developing a secondary mortgage market.

Frankly, I would not feel qualified to answer a question as to the development of a secondary mortgage market for conventional loans. We do have, as you know, Mr. Chairman, -- I do not know whether it is appropriate to say this at this point -- one or two specialists in this field. I do not know whether Mr. Townend of the Toronto-Dominion Bank would have any comment to make with respect to your question about a secondary market for conventional mortgage loans. In the comments I have made as to our views regarding the banks' entry into this field I have not taken into consideration to any great extent a secondary mortgage market.

COMMISSIONER LEMAN: But you had in relation to N.H.A. loans?

MR. WADSWORTH: I think it has been in the minds of all of us for some time that the development of this market could have a bearing on the degree

of the banks' participation if they felt there was an active secondary market.

COMMISSIONER LEMAN: But would the existence of a good secondary market for N.H.A. loans be a key factor in the entry by the banks into that field?

MR. WADSWORTH: I would not think it would be a key factor, but I think it would be a factor to the degree of entry into it, or to the degree of re-entry into the N.H.A. field.

COMMISSIONER LEMAN: It was said earlier that one of the principal factors that caused the banks to leave that market was the trend of interest rates, and the 6 per cent ceiling. But, were there other factors that applied to N.H.A. loans and the whole set of conditions that was created by the C.M.H.C. about which the banks had some complaint, or about the working of which they were not quite satisfied?

MR. WADSWORTH: I think, as far as the banks were concerned, we had no particular point of issue on N.H.A. mortgages apart from the -- and I come back again to this -- ceiling, the 6 per cent limit. In the development of a secondary mortgage market there are a number of areas that our specialists in this field have given some thought to, the resolving of which they feel would probably be of assistance in the development of a secondary mortgage market.

I mentioned earlier, and you might

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presence of a [illegible]

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MR. MA[illegible]: [illegible]

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already have had these placed before you, that there are a number of details here, and Mr. Townend would be glad to mention them at this time if you so wish.

COMMISSIONER LEMAN: While we are on the subject we might as well hear from him instead of coming back to this later on.

MR. TOWNEND: Going back to the earlier point about the question of the secondary market for conventional loans, there may come a time when pension funds, which are buyers of mortgages, might wish to purchase higher interest yielding conventional mortgages as well as purchasing N.H.A. mortgages. The development of the secondary market is still in its infancy, and we do not know if that will arise.

Regarding the second point of suggested improvements in N.H.A. mortgages for the purpose of the secondary mortgage market, thereare a number which I believe you have already had including these: the making of all N.H.A. mortgages, 100 per cent guaranteed, instead of only the ones that were processed on and after March 20, 1959. The bulk of bank portfolios comprise mortgages that are not 100 per cent guaranteed.

Other suggested improvements are: make transfer procedures less costly and less cumbersome; make C.M.H.C. mortgages available in blocks to suit purchasers, and have them readily available at a negotiated or stated price; if the auction procedure is to continue then disclose more information for the market in relation to high, low and accepted bids;

run auctions more frequently compatable with the necessary market protection period; and improve foreclosure procedures and claim settlements.

There is a further point in regard to title warranty. Mortgages that are sold from the government portfolio contain a warranty that title to the mortgage is good. In our own case we do not know that until a claim is made. Before a claim is paid we must be able to give the Corporation a clear and acceptable title. We do not know until after the claim is submitted whether that title will be accepted.

Those are just a few points, Mr. Chairman.

COMMISSIONER LEMAN: But these are points that have to do with the marketability of mortgages.

MR. TOWNEND: Yes.

COMMISSIONER LEMAN: But when the banks are the originators of N.H.A. loans they have to look at the title themselves. They have to satisfy themselves as to the title.

MR. TOWNEND: Yes. That is done by a qualified lawyer.

COMMISSIONER BROWN: The last sentence in paragraph 210 reads:

> " If the Canadian chartered banks enter more heavily into longer term investments, it would appear logical that the Bank of Canada be prepared to accept for rediscount some of the longer

term instruments that would be acquired by the banks in the process and for longer rediscount periods than would be now possible."

Would anybody like to comment upon the advisability or feasibility of rediscount privileges for N.H.A. mortgages?

DR. McLEOD: Mr. Chairman, if I may speak for the group on this, we do feel that there would be quite different considerations in mind in rediscounting for this type of operation. That is to say, the present rediscounting facilities of the banks could be briefly said to be a facility for short-run adjustments of cash positions. If this question arises it should be pointed out in connection with the suggestion that the banks should be induced to go rather further into long-term lending, or mortgage lending, than they would in the exercise of their own decisions along the lines mentioned by Mr. Wadsworth earlier, that there are programs that would induce them to go further into this lending. However, I think it would be fair to say that we, the banks, would need some additional facilites for rediscounting on a different basis and for a different purpose in case financial conditions change so that our resources seemed to be needed more for the type of lending, such as the provision of short-term capital, that the banks are particularly fitted to provide.

There would have to be, then, some way, in the interests of the whole community, not only in

the interests of the banks, of freeing up these resources, for bailing the banks out or rediscounting, partly because of the fact, as has been mentioned, that these assets, unlike bonds, are not very readily marketable in the ordinary course of events.

I think the distinction is that the conditions would be quite different, and perhaps this underlines the point that the banks' resources may be employed in different areas according to the funds available to them, and according to the pressure of demand for various types of loans. Perhaps I might say that to some extent it would be a question of volume.

In our own submission we say that it would be logical but not necessarily essential to have this type of facility, and I think that would be interpreted partly in terms of the volume involved. If it was a relatively small volume it would not be important, but if we ended up by having a substantial block of our funds tied up in this type of investment and then conditions changed so that our funds appeared to be needed for the type of short-term lending that the banks seem to be peculiarly suited to grant, and which do not seem to be available from others, then we would feel that this facility would become more necessary.

--- Short recess.

THE CHAIRMAN: The meeting will now resume.

COMMISSIONER BROWN: Mr. Mulholland, I wonder if someone in your group would discuss for the record the recently announced limited degree of re-discount privileges by CMHC, and their estimate of its adequacy or otherwise?

MR. TOWNEND: I note that one of the first provisions would be to make existing portfolios 100 per cent guaranteed, and not only those that were made 100 per cent guaranteed after March, 1959. The bulk of the banks' portfolio is comprised of mortgages made prior to that date. While the secondary market at the moment is mainly confined to mortgages in portfolios from CMHC, we can see a time coming when the banks and others may wish to dispose of some of their existing portfolios.

COMMISSIONER BROWN: Has there not been a recent announcement of some sort of re-discount privileges through CMHC?

MR. TOWNEND: Yes.

COMMISSIONER BROWN: I have not seen the details of it. Have you got the details of it?

MR. TOWNEND: Not here. I am not quite clear on your question, sir.

COMMISSIONER BROWN: Was there not a recent announcement of some form of re-discount privilege being available at CMHC?

MR. TOWNEND: The recollection I have is that the short-term lending was to enable people to purchase mortgages and carry them until they are turned

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Mr. [illegible]

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Mr. [illegible]

over against subsequent investments.

COMMISSIONER BROWN: Is this a feasible operation as far as the banks are concerned?

MR. TOWNEND: I don't think it would affect the banks, sir.

MR. WADSWORTH: May I comment on that, sir.

We will get further information on this question, but my understanding is that CMHC has announced that they would make advances to dealers who were carrying mortgages for sale at some rate, probably above the rate applicable on the mortgage. I do not think that ties into what we were speaking about before the recess; it is to assist in the marketing of these mortgages, as I understand it.

COMMISSIONER BROWN: This has not been mentioned before, and I thought it should be put on the record.

MR. WADSWORTH: Yes.

COMMISSIONER BROWN: Secondly, I was wondering if you could give us a comment, Mr. Mulholland, on the two suggestions that have been made to this Commission. After all, the banks are holders of very large amounts of NHA mortgages. One suggestion was that the NHA rate might be freed and let the market find the proper level; the other was the feasibility, or practicability, or adviseability of having NHA mortgages on existing houses.

MR. WADSWORTH: May I endeavour to answer that question, Mr. Brown?

In the first instance our view is, I think,

that we do not favour a fluctuating market rate on NHA loans. We think it would be better that the rate be set.

I might add that we probably favour more flexibility in the changing of the rate from time to time. However, we would prefer, speaking for ourselves at least, that the rate be set from time to time.

COMMISSIONER BROWN: Could I ask you why?

MR. WADSWORTH: I think there are a number of reasons. I think with a fluctuating rate, or mortgages with the rate changing, or mortgages selling at a discount, you probably get an unevenness of rates throughout the whole field of National Housing Act mortgages.

This is part of a broad program. In its own way it is probably an essential national housing program in smaller outlying areas than it is in the larger metropolitan areas. In other words, this is part of an overall national program, as against the changes that might take place and do take place in rates of conventional mortgages on home loans. I think that would be the prime reason.

COMMISSIONER BROWN: Were you going to deal now with the second question, Mr. Wadsworth?

MR. WADSWORTH: As to your second question, Mr. Brown, I know that many changes have been made along this line, both pro and con. As I understand your question, it is as to whether NHA mortgages should be made available on present housing.

Speaking for ourselves, we have no very

definite view in this regard. The decision is one to be made by the federal government, in the first place; but until we have had an opportunity -- and we hope we will have the opportunity of being able to enter as another lender in the conventional home field -- I don't think we would have any strong views at the moment one way or the other. Our views would probably crystallize more when we had that permission and we saw the effects of our participation in the conventional loan field.

COMMISSIONER BROWN: Have any other general managers any views on this point? I think it is quite important.

MR. BOYLES: There are a number of arguments pro and con. Generally speaking, there is much to be said for this type of thing, but it certainly requires much more consideration than has been given it up to this point.

If I may refer to some notes I have made on this question, these are some of the arguments against the proposal:

It would make older houses more attractive and tend to increase demand, thereby tending to increase prices. Price increases would tend to affect the amount of funds available for other purposes, that is, new houses.

It is by no means certain that the application of NHA to existing houses would increase demand for new houses.

NHA prescribed terms would be necessary.

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MR. [illegible]: [illegible]

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The supply of private funds is probably fixed at any one time; therefore, there would be less for new housing, thus diminishing the supply of new houses.

Private lenders have been lending $200 million to $300 million annually on existing residential property as conventional lenders, earning more than the NHA rate. It is doubtful that they would continue to do so on NHA terms.

The average loan per transaction would increase. There would tend, therefore, to be an increase in the government's role as residual lender. Of course, administrative problems would result, such as appraisals, policing and so on. These are few of the arguments against the proposal.

COMMISSIONER BROWN: Do I gather that you have no arguments in favour of it?

MR. BOYLES: I will put it this way: there are more arguments against it than for it at this point.

COMMISSIONER BROWN: Is this a unanimous view?

MR. BOYLES: I don't suggest that it is, sir.

MR. MULHOLLAND: It is very difficult to get a unanimous view in C.B.A.

THE CHAIRMAN: There is unanimity about the 6 per cent, is there not?

COMMISSIONER LEMAN: While we are talking on the subject of the length of loan considerations, short against long, I would like to get a bit of information about term loans to businesses. What are the trends in this field? Is there a noticeable trend

towards or away from term lending in Canada by banks?

MR. BOYLES: If I understand your question, Mr. Leman, it is as to whether there is more demand apparent for such loans?

COMMISSIONER LEMAN: Yes.

MR. BOYLES: I believe it is fair to say yes. As you know, the demand seems to have been more apparent perhaps with the post-war expansion when so many small businesses found that they did not have access to the capital markets, and naturally came to their banker; and the bankers, seeing the circumstances which prevented these people from getting their finances in the conventional manner, provided these services, and there has been a fairly steady demand throughout the last several years.

COMMISSIONER LEMAN: That is as to the demand; how about the response?

MR. BOYLES: The response, of course, has been limited to some extent by the monetary conditions, but it is the policy generally of the banks to look after the small businessman who does not have access to the market or to other lenders. Here again one might supplement that by saying this is another service that the bank feels it should and does make available to the small type of borrower.

There is another reason. In many cases there is no need for a particular borrower to embark on a program of long-term borrowing. He probably wants the money for two or three years - we regard that as a term loan. In other words, if he were to go to the

capital markets he might not find a wide display of interest if the term required was of a relatively short nature.

COMMISSIONER LEMAN: When you talk about a term loan from the bank, would a two or three year term be a typical term loan?

MR. BOYLES: Not necessarily, Mr. Leman. It might be for a longer period. Here again it depends on the circumstances. The borrower who has no access to the market might indeed require it for a much longer period.

COMMISSIONER LEMAN: What I would like to know is what the banks have done; for how long have term loans be granted?

MR. BOYLES: In respect of term?

COMMISSIONER LEMAN: Yes, in the length of the term.

MR. BOYLES: I would suggest that they could range anywhere from two to as much as ten or twelve years.

COMMISSIONER LEMAN: Does the bank have some figures, some statistics that they give us on that?

MR. BOYLES: In respect of term?

COMMISSIONER LEMAN: In respect of the term loan business, its characteristic, and how many there have been.

MR. BOYLES: We do have statistics covering this very subject. I am not sure that it provides a table of terms, broken down by classification of years, but it could be developed very readily and we

would be happy to hand this statement in due course to the Secretary of the Commission.

COMMISSIONER LEMAN: What are the other characteristics of such loans? Do they attract a higher rate of interest than the ordinary working capital loan?

MR. BOYLES: Normally they do, when it is possible for us to move within the ceiling. In other words, the answer to your question is that normally they do command a higher rate than the average commercial loan.

COMMISSIONER LEMAN: What would be the spread?

MR. BOYLES: Here again, today, when the prime rate is 5-3/4 per cent, the rate for term loans would be 6 per cent. Let us assume that the prime rate was 5½, we would probably charge 6 per cent for term loans.

COMMISSIONER LEMAN: The monetary authority has at times had suggestions to make to the banking system about term loans. But let us just imagine that there were no special rules affecting term lending, and let us imagine also that there were no 6 per cent ceiling. On that assumption, from the point of view of the banks and their preference, what do you think would be the development in term lending business? I am basing that question on the assumption that there were no rules, no impediments of any kind.

MR. BOYLES: Normally it goes back to some earlier consideration, that one has to think in terms of the composition of the asset portfolio. In other

words, we still have to keep in mind liquidity requirements, the availability of money, and the fact that this type of borrower should, if he can, go to the capital markets for his requirements. In other words, to carry it another step, usually each of these applications is considered in the light of the financial position of the applicant. If a banker were to decide that this type of borrowing should be done in the capital market or through the conventional long-term lenders, we would urge the applicant to do so.

COMMISSIONER LEMAN: We have seen earlier that a large proportion of the more conventional working capital loans do tend to stay on the books for longe periods, despite some fluctuations, as Mr. Neapole pointed out. I am wondering what real difference it makes.

MR. BOYLES: First of all, you don't regard availments under a separate line as term loans, although it is true that there is a hard core of loans that never seem to be liquidated or removed from the books. But in the case of term loans, it is known at the outset that an applicant requires this money for a specific term. There is a definite understanding at the outset that this loan is required for a certain term of years.

COMMISSIONER LEMAN: Could we have something for the record as to the trend, how much term lending has been expanding? Are there any figures that would give us the order of magnitude over a period of time? Let us take the postwar period: is there a definite trend towards more lending, and if so, how much?

words, [illegible]

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pointed out. I am [illegible]

[illegible]

MR. [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

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[illegible]

[illegible]

[illegible]

[illegible]

MR. BOYLES: We can supply you with statistics to show the trend in that period, and we will be very happy to do so.

THE CHAIRMAN: To come back for a moment to the statement of the assets on March 31, 1962 - have you a copy of that, Mr. Mulholland?

MR. MULHOLLAND: No, I have not, Mr. Chairman.

THE CHAIRMAN: This was supplied to me in your brief. However, I think I can deal with it.

In breaking down the groups of items here, and the relative amounts, it would appear to me to work out somewhat in this way: the most liquid assets, consisting of Bank of Canada notes and deposits, day-to-day loans, treasury bills, Canada Bonds, net foreign assets, call loans - amounting, to be exact, to $5,026 million. That is the first group.

The second group consists of provincial securities, municipal securities, corporate securities and NHA mortgages are thrown into that group as securities and not included in the loan group.

The total of those assets amounts to approximately just under $2 billion, $1.992 billion, if I have added it up correctly, which is not necessarily so. That is the second group. We come to the loans: provincial, municipal, grain dealers' loans, instalment finance companies, C.S.B. loans, personal loans, farm loans, institutional loans, and business loans, a total of approximately just under $7 billion, $6.929 billion, to be exact. The total is $13.948 billion. So, the relative proportions are about five to the liquid assets, about two to the securities, and about seven to the loans. That would be the proportion. I suppose that in the course of time those proportions change considerably, do they not?

MR. MULHOLLAND: Mr. Chairman, to answer that point, I have the figures here for January 2, 1963.

THE CHAIRMAN: Yes.

MR. MULHOLLAND: And I can give you the round figures. The total is $14.337 billion which is within $400 million of your total.

THE CHAIRMAN: Yes.

MR. MULHOLLAND: The total under what you classify as the liquid assets, at, let us say, above the line, is $4.873 billion.

THE CHAIRMAN: Yes.

MR. MULHOLLAND: And, with respect to the security group, may I ask, sir, whether you included the insured mortgages in that total?

The total of these asset amounts is approximately two million dollars. [illegible] will have about it up [illegible] which is not [illegible]. What is [illegible] second group [illegible] of the [illegible] dollars' loans, [illegible] C.S.B. [illegible] loans, [illegible] loans, and [illegible] had under [illegible] The total is [illegible]. [illegible] on the liquid [illegible] [illegible] in the [illegible] [illegible], or they [illegible].

[illegible]

[illegible]

Mr. [illegible] I [illegible] [illegible] which is about $100 [illegible].

[illegible]

[illegible]

[illegible] liquid [illegible]

[illegible]

Mr. [illegible] the [illegible]

THE CHAIRMAN: N.H.A. mortgages are here included as securities in that group.

MR. MULHOLLAND: The total for that group is $2.018 billion. That indicates the same from your date in March to January of this year, January 2nd, to be precise. This is taken from the Bank of Canada weekly figures.

THE CHAIRMAN: Those are N.H.A. mortgages?

MR. MULHOLLAND: No.

THE CHAIRMAN: The whole group?

MR. MULHOLLAND: Mortgages: provincial, municipal and corporate securities.

THE CHAIRMAN: Then the N.H.A. mortgages must have declined?

MR. MULHOLLAND: As of January 2nd they were $918 million.

THE CHAIRMAN: That would cover the pay-offs.

MR. MULHOLLAND: The run-offs.

THE CHAIRMAN: Well, there is not a great difference there than the proportions from March 31, 1962. There does not seem to be a great change. Would you say these proportions are more or less in the usual proportions you will find in the business or are there times when the fluctuations are quite substantial as between one group of assets and another?

MR. HACKETT: Perhaps I could answer that, Mr. Chairman. Over a period of perhaps six

months to a year, depending on the credit conditions, there could be a swing of -- and I am speaking rather generally now -- of perhaps up to ten percentage points ---

THE CHAIRMAN: Yes.

MR. HACKETT: -- in what we would term the ratio of loans and non-federal government investments to deposits.

THE CHAIRMAN: I will see if I understand that.

MR. HACKETT: We have a tendency to group loans and non-federal government investments, and mortgages, I should add.

THE CHAIRMAN: Yes, well, that would be the provincial, municipal, corporate securities?

MR. HACKETT: Plus insured mortgages.

THE CHAIRMAN: Yes.

MR. HACKETT: That is roughly the difference between what we would regard as a highly loaned position and a more normally loaned position.

MR. MULHOLLAND: If I may add, Mr. Chairman, the largest swing in the year, from January 1962 to January 1963, in other government securities, shows a decline of $426 million, and an increase in general loans of $750 million. So, to that extent there are large swings.

THE CHAIRMAN: Yes. The largest swings are with the business loans?

MR. MULHOLLAND: Business loans, yes.

THE CHAIRMAN: That is where the largest

swings occur?

MR. MULHOLLAND: Yes.

THE CHAIRMAN: Looking at the business loans alone, what are the swings?

MR. MULHOLLAND: From January to January?

THE CHAIRMAN: All right.

MR. MULHOLLAND: Mr. Chairman, the monthly classification of general loans from the Bank of Canada statistical summary, November, 1962, shows on page 668 the swings in business loans. Using March 31, 1962, I have a total of $3.769 billion, whereas on October 31, 1962, which is the closest I can get to the date of January I have been talking about, the total is $4.250 billion.

THE CHAIRMAN: Yes. Then, if you look further back to September, 1960, it was $3.245 billion.

MR. MULHOLLAND: That is right, sir.

THE CHAIRMAN: That is about $1 billion less than in October, 1962.

MR. MULHOLLAND: $1 billion less, right.

THE CHAIRMAN: So that there is quite a big swing in that type of investment? When you look at the personal loans in looking at this same document, for September, 1960, the figure is $826 million, and in 1962 it is $1.199 billion. So that there has been a pretty steady increase there, and the total general loans go from $5 billion to $6.6 billion.

MR. MULHOLLAND: And $55 million.

THE CHAIRMAN: Yes, $6.655 billion. That is all a fairly steady increase during that period, is it not?

MR. MULHOLLAND: Right, sir.

THE CHAIRMAN: Are there figures here that go back earlier to show the performance?

MR. MACARTHUR: The figures on the annual basis are shown on page 664, sir.

THE CHAIRMAN: I do not know that I need go into too much detail on this. I just wanted to get the general picture.

COMMISSIONER BROWN: Could I ask one question in the description of these loans, Mr. Chairman?

THE CHAIRMAN: Yes.

COMMISSIONER BROWN: Where do loans to the instrumentalities of provinces, guaranteed by the provinces, come? Do they come under general loans or loans to provinces?

MR. MULHOLLAND: Loans to provinces, Mr. Brown.

COMMISSIONER BROWN: They all come under loans to provinces?

MR. MULHOLLAND: You are referring to municipal?

COMMISSIONER BROWN: No, I am referring to loans to, say, Ontario Hydro or B.C. Electric, B. C. Hydro? Where do those appear in your statistics?

MR. BOYLES: The loans are made to the body of the government. I believe that is what you

THE CHAIRMAN: Yes, [illegible]

That is all a [illegible] that period, is it not?

MR. [illegible]: [illegible]

THE CHAIRMAN: Are there figures here that go back earlier [illegible]

MR. [illegible]: The figures on the annual basis are shown on page [illegible], sir.

THE CHAIRMAN: I do not know that I need go into the [illegible]. I just wanted to get the general outline.

[illegible]: Could I ask one question in the description of these loans, Mr. Chairman?

THE CHAIRMAN: Yes.

[illegible]: Where do I get to the [illegible] provinces, [illegible] by the provinces, [illegible]? Or they were given general loans or loans to provinces?

MR. [illegible]: Loans to provinces, Mr. [illegible].

[illegible]: [illegible]

MR. [illegible]: [illegible]

[illegible]: No. I am referring to loans to, say, [illegible] B, C, D and E? [illegible] statistics?

MR. [illegible]: The loans are made to the governments. [illegible] that is why [illegible]

have in mind, is that right, or are guaranteed by the province?

COMMISSIONER BROWN: To the instrumentality of the government?

MR. BOYLES: They are shown under provincial government loans, always. That is the particular type to which you refer. Let us assume that some commercial loan happened to have the guarantee of the province behind it. That would be shown under general loans. Loans to the Ontario Hydro, let us say, come under general loans.

COMMISSIONER BROWN: That is the question I asked. I wanted to know about loans to the Ontario Hydro or the B.C. Hydro. Those appear under general loans?

MR. BOYLES: Yes.

COMMISSIONER BROWN: What is your security?

MR. BOYLES: Usually in that type of loan we have the guarantee of the province.

COMMISSIONER BROWN: This is your only security, is it not?

MR. BOYLES: Usually. I cannot think of any other type of security at the moment.

COMMISSIONER BROWN: How about under securities? You have provincial securities, municipal securities, and corporate securities. Where would Ontario Hydro bonds appear?

MR. HACKETT: That, Mr. Brown, would be under provincial securities.

COMMISSIONER BROWN: Can we have an explanation as to why these are treated differently?

MR. HACKETT: This is really an accounting matter, and I speak subject to correction here, but I think the banks are required to place these under various headings in the reporting they make to the Bank of Canada and the government. It is a chief accountant's classification, and I think they have certain direction in that respect.

I may say that from the securities end we would not normally tend to differentiate between a provincially-guaranteed obligation such as Ontario Hydro and an obligation of the province itself. It would seem to fit the practicalities of the matter.

COMMISSIONER BROWN: Why, when you come to loans, do you put them into different categories?

MR. MACARTHUR: May I interject that the table shows direct and guaranteed securities.

COMMISSIONER BROWN: I am asking why there is this distinction when you get down to loans?

MR. WADSWORTH: I think it would be fair to say on that, as Mr. Hackett was saying, Mr. Brown, that the classifications we follow on loans within that heading of general loans -- it is a fairly lengthy one and it has been submitted to you -- has been done by agreement. In other words, in agreement with the authorities in Ottawa and the central bank, who request this information, they set out various categories as to occupation. It could

be a Hydro loan guaranteed by the government, but in their opinion, and in ours, it is a public utility loan. They are endeavouring to get not the security behind it as much as the broad diversification behind it, and the trends in certain years.

MR. BOYLES: Usually you find that the classification of the components of a balance sheet is a matter of instruction to the banks from the Inspector General of Banks.

COMMISSIONER BROWN: You have given me a more direct answer than anybody else. Thank you very much.

THE CHAIRMAN: If the chartered banks were not permitted to engage in the savings business, as they are not, apparently, in the United States, that would substantially change the asset picture, would it not? In other words, the relationship between the liquid and less liquid securities would be greatly different if you did not have the savings deposit business?

MR. WADSWORTH: May I revert, if I understood it correctly, Mr. Chairman, to the first part of your statement, that the commercial banks in the United States were not permitted to operate in the savings field. They do. They always have. I believe that in a certain period in the United States they probably had not paid the attention to the savings deposits that they had in the past.

THE CHAIRMAN: I was under that impression. I do not know where I picked that up.

MR. WADSWORTH: But they still have substantial amounts of savings deposits.

THE CHAIRMAN: They are not allowed to cheque. They do not have chequable accounts.

MR. BOYLES: It is not the practice to have chequing against savings, but about one-third of the deposits are, I believe, personal savings deposits.

THE CHAIRMAN: And those savings are used in the same way as the savings are in your system, or are they segregated in some way? Is it departmentalized, in other words?

MR. BOYLES: I think to a degree there has been more of a tendency to departmentalize them in the United States, particularly in the specialized savings institutions.

MR. LORENZO HEBERT: I think the commercial banks have savings deposits the same way as Canadian banks, and that the use of them is not restricted in any way, not any more than they are in Canada.

THE CHAIRMAN: In the United States?

MR. LORENZO HEBERT: Right.

THE CHAIRMAN: As to personal loans, it has been suggested that the banks are in a position to take the cream of this business away from some other competing institutions, who are left with the more risky part of this business. Is there any truth in that allegation?

MR. BOYLES: Mr. Chairman, I do not

like to think there is proof of that allegation, as a direct answer to your question, but we feel that this type of lending is a natural field for the banks to serve, and also we are equipped through our wide-spread chain of branches to reach the consumers who require this type of financing, and who do not have access, perhaps, to the other types of lending institutions. I repeat that we are in a position to provide this service and it is the natural field in which we should be operating.

THE CHAIRMAN: If the 6 per cent ceiling were lifted, would that open up to you further prospects of business in the way of personal loans?

MR. BOYLES: Not necessarily, Mr. Chairman; much could depend on the cost in every direction. In other words, the cost naturally here is one of the prime basis for the charges and I don't think it is fair to suggest that if the ceiling were removed that there would be an immediate increase in our charges for this type of loan.

COMMISSIONER BROWN: Have you costed these loans as against ordinary loans? What is the difference in cost?

MR. BOYLES: Well, first of all, Mr. Brown, there have been tests made and estimates made from time to time and I think that it is fair to say that we have not reached the point where we consider that we have factual cost or cost that can really reflect what the experience will be.

You will appreciate that most of the banks are fairly new in this field, and also that there is a waiting on non-recurring costs in getting embarked, as it were; you have to get your organization established, perhaps you have a heavy selling campaign through the medium of advertising, or otherwise, and naturally it follows until you have a volume built up or you have brought about more efficiency by having your staff trained with experience, that it is pretty difficult to determine

what might be regarded as a realistic cost basis.

COMMISSIONER BROWN: Are they more costly to service than ordinary loans?

MR. BOYLES: Yes. In the first place the conventional type of loan -- and I am speaking generally, of course -- it doesn't require the same processing costs, it doesn't require the same collecting costs, and, of course, you recognize, too, that this type of loan is an instalment loan.

COMMISSIONER BROWN: I am sorry, I used the wrong word in my question; I meant to say are they more profitable or less profitable than ordinary loans? You don't know yet?

MR. BOYLES: Actually, we have determined with some degree of accuracy what our costs are, but it wouldn't be fair for me to suggest that they are either more costly or less costly.

COMMISSIONER BROWN: You used the same word, but you mean more profitable or less profitable?

MR. BOYLES: Right.

THE CHAIRMAN: Well, at the present time is it right to say that the business of the banks in this field is 6 per cent business, and when you leave that and you get into the finance companies' activities there is a sudden jump, the rates are considerably higher than 6 per cent on the average, are they not?

MR. BOYLES: Mr. Chairman, this goes back really to the point Mr. Brown made as well.

In the case of the conventional loan

it is generally regarded that the overall interest factor should compensate you not only for the cost of funds required in the operation, but also the administration costs.

In the case of the instalment credit loan, where we know that the cost of dealing with this type of loan is, indeed, considerably higher than that pertaining to the normal conventional loan, that there are certain costs that must be recovered by additional charges, and that is the reason for the difference in the overall cost of the loan.

THE CHAIRMAN: Well, if the 6 per cent rate was raised, would you then increase the interest rate on these loans and include in the rate of interest the finance charges?

MR. BOYLES: It is not inconceivable.

THE CHAIRMAN: But now you do make certain finance charges on this type of loan?

MR. BOYLES: To compensate us for the unrecovered costs.

COMMISSIONER BROWN: I am surprised at the banks going into a field like this and not knowing whether it is profitable or not.

MR. BOYLES: We had, Mr. Brown, of course, the benefit of the experience of others more especially outside of Canada, and we were able to base some of our thinking and estimates, and so on, on their experience.

COMMISSIONER BROWN: You must have some

estimates, then, of these costs.

MR. BOYLES: Sorry?

COMMISSIONER BROWN: You must have some estimates of these costs?

MR. BOYLES: We do, sir.

COMMISSIONER BROWN: All right. Then, based on these estimates, are these more profitable or less profitable than ordinary lending?

MR. BOYLES: Based on the estimates, they are less profitable.

COMMISSIONER BROWN: Than ordinary lending?

MR. BOYLES: I am thinking in terms of individual loans, yes.

COMMISSIONER BROWN: I am puzzled, Mr. Chairman. We start with the most profitable business, securities, and the next less profitable business is loaning, and the least profitable business is the new branch, personal loans. I am confused; I really am. This can't be so, surely.

MR. BOYLES: Well, first of all, as I said earlier, we don't have the real cost figures, but the estimates show that they are indeed less profitable than the usual conventional loans. I am talking about an individual loan. One of the important factors one must consider is that volume is of necessity a requirement.

COMMISSIONER BROWN: Why go into it if it will be less profitable? That is what I don't follow.

MR. LORENZO HEBERT: There is a very heavy demand from our customers; they need this more and more and more every year. They insist on getting them; it is part of our modern life, and that is one type of service that maybe we didn't have to provide 25 years ago but that we have to provide today.

COMMISSIONER BROWN: You made quite a lot throughout the brief of these accounts that are not being charged enough; the current accounts are not paying their fair share of charges, and so forth. Why not when you start on something new like this, why not charge enough to make a profit on it? Apparently you still have a margin between what you are charging and the competition. I don't understand this.

MR. NEAPOLE: I could say something on that, because we were the last bank to come into this, or almost the last, and we made a large volume of these loans year after year after year at 6 per cent, and on the advice of our solicitors -- we were told that anything more than six in a total, so to speak, no matter how you described it, was illegal. However, we finally found there were other solicitors' opinions, too! It is like changing your doctor sometimes, but we found there were other solicitors' opinions and we started out on our term plan by charging 6 per cent simple interest, plus $1.60 per month per thousand as a service charge.

Now, I don't know yet what our costs

[illegible]

[illegible] more [illegible] getting [illegible] that is [illegible] [illegible] people [illegible]

[illegible]

a lot thoroughly [illegible] are not [illegible] forth. [illegible] like this, why not [illegible] on [illegible] what you [illegible]

[illegible] it, because [illegible] up except [illegible] those loans [illegible] them, and [illegible] more and [illegible] so to speak [illegible]

[illegible] additional [illegible] been having [illegible] other [illegible] those with [illegible] also both [illegible]

are because we have only been in it since April, but I am prepared to guess that we are probably breaking even, but what we have done is convert business that was being done at 6 per cent -- I am admitting it -- a lot of business being done at 6 per cent to business which is now using about 9.6, and it is as simple as that.

THE CHAIRMAN: To translate, the 6 per cent interest rate plus the finance charges?

MR. NEAPOLE: That is right.

THE CHAIRMAN: You come to an overall interest rate, and it comes to about 9½ per cent?

MR. NEAPOLE: Yes. It varies a little bit.

THE CHAIRMAN: It might be more than that?

MR. NEAPOLE: It varies a little wee bit according to the actual time the thing is outstanding, but I think it runs from about 9.52 to about 9.6, the average interest cost.

THE CHAIRMAN: But if the solicitors who have the opinion that it was illegal to make a service charge, if they were right, then if, as and when the 6 per cent is lifted, you would be charging interest rates of 9½ or more?

MR. NEAPOLE: That would be my guess. It would be a competitive thing, actually.

THE CHAIRMAN: You will be competing?

MR. NEAPOLE: The price will be determined pretty well by the market, I think.

are inclined to [illegible]

I am prepared [illegible]

them, but what we [illegible]

that was being done [illegible]

it -- a lot of [illegible]

[illegible]

as simple as that.

[illegible]

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interest [illegible]

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[illegible]

[illegible]

[illegible]

this according to [illegible]

proceedings, [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

It would [illegible]

[illegible]

[illegible]

THE CHAIRMAN: You will be competing with the finance companies?

MR. NEAPOLE: As well, and everybody else who is lending like that; department stores, if you will, on their time accounts, and everything else.

COMMISSIONER BROWN: I think that Commerce has been in this business longest, haven't they?

MR. WADSWORTH: Yes.

COMMISSIONER BROWN: Can you give us the benefit of your experience on this?

MR. WADSWORTH: We submitted quite detailed figures at the time of the Bank Act revision. I can't submit similar figures at this time. At that time, apart from our own bookkeeping we had chartered accountants studying it.

COMMISSIONER BROWN: What is the picture in general terms?

MR. WADSWORTH: Speaking in general terms, our experience on this point and with a rough allocation of costs -- and I don't want to be too lengthy -- but the problems between banks vary; some centralize and some are unable in a branch to do this, and it is hard to cover the whole overhead cost in it, but I would certainly think from our experience -- the volume has a bearing on this -- that they are at least as profitable as other lending outlets.

COMMISSIONER BROWN: Have you found it

necessary to change your overall charges since you started?

MR. WADSWORTH: Well, ours does change a bit because here, again, procedures differ. With all due respect to another general manager, we had a different legal opinion back in the 1930's and it indicated that we were within the legal requirements.

THE CHAIRMAN: Which legal opinion did you pick?

MR. WADSWORTH: Mr. Chairman, we frankly only had ---

THE CHAIRMAN: I will not press that.

MR. WADSWORTH: We only had one legal opinion, which came from our solicitors at the time and which we were provided with throughout, so our procedure is a little different; we don't make a service charge with the loan -- and I think this is all outlined here -- a deposit is placed in the savings account, so our rate varies because of the deposits that are made, which ultimately liquidate the loans, they are paid interest at the current savings rate, so that as that rate may change from time to time the overall -- you might say that the effective cost varies -- and that while the basic 6 per cent rate that we charge on the loan when it is granted is not changed, the amount of interest that the borrower will receive on the savings account is varied, and therefore reduces his overall cost of the loan. Does that answer your question?

COMMISSIONER BROWN: In other words, your charges have, in fact, been going down?

MR. WADSWORTH: As the savings rates went up.

COMMISSIONER BROWN: Because you always charge the 6 per cent on the loan side?

MR. WADSWORTH: That is right.

COMMISSIONER LEMAN: How do you feel about the ceiling on that kind of business, the rate ceiling or some kind of a regulation of the terms on personal loans?

MR. WADSWORTH: I don't think as far as banks are concerned, Mr. Leman, that we would require a ceiling, and I mean this most sincerely; competition would ensure that the rates did not get out of line. All banks or most banks are now into this field; it is true that we were into it for quite a period alone, but I feel quite sure that as other banks build up a volume -- and they are doing it very rapidly -- that that would be the greatest safeguard that the rates would not become out of line between the banks.

COMMISSIONER BROWN: Could we have a picture of what the different rates are, or do you have to go and borrow from another bank in order to find out what they are charging you?

MR. NEAPOLE: I know, but I wouldn't want to quote it myself. We have studied it, of course, because of the competitive feature.

COMMISSIONER BROWN: Could the C.B.A.

tell us?

MR. MULHOLLAND: We haven't got that figure, Mr. Brown.

COMMISSIONER BROWN: A series of figures on the range of charges.

MR. MULHOLLAND: We watch each other very closely and we are very competitive.

COMMISSIONER BROWN: Could we get this, or do we have to send our staff out to borrow some money?

MR. MULHOLLAND: No, we can provide those.

COMMISSIONER BROWN: The Secretary wants to know if I can guarantee that the staff will be able to get the loans!

MR. LORENZO HEBERT: For sample purposes.

MR. MULHOLLAND: There is one feature about these loans that I think should be brought into the record; they are proving -- as the other general managers have said -- very popular in the bank branches. It provides a very all around service at every branch of any bank that is in this business, and in remote places as well, and in large cities, which is most important, and one feature of it which seems to be very acceptable to the borrower is the life insured feature.

Previously when loans were granted on a personal basis, and speaking for my own bank we have been in the personal loan field as such for many years, fifteen or twenty years, and had a large

volume of personal loans on our books, and we find that in converting these loans over to this special type of loans that the borrower is very attracted to the life insured feature, and in many cases people who have been borrowing from us more or less on a demand basis, not on the instalment basis, have asked to have these loans converted into personal loans under the instalment plan.

COMMISSIONER BROWN: The credit unions in their various appearances before us made quite a point of the fact that once they had made a loan to somebody, that person in turn in time paid off the loan and became a depositor. Has this been the experience of the banks?

MR. BOYLES: This is one of the beneficial or supplementary benefits from this type of business. In other words, there are a lot of collateral advantages if you can attract these people into your branches; you find that they become depositors and use the various services offered by the banks.

COMMISSIONER BROWN: It is an off-setting factor.

MR. BOYLES: It is another added factor which you can't really measure in terms of dollars and cents.

MR. NEAPOLE: I should have said that our plan includes this life insurance feature in the $1.60 per month per thousand service charge to the amount of the loan.

COMMISSIONER BROWN: I think it is included in the special loans of all the banks, is it?

MR. NEAPOLE: I am not sure about that.

THE CHAIRMAN: I suppose this insurance feature is a good thing for the banks. The man who takes out the loan dies, and the widow can keep the washing machine and the bank is paid off and there is a customer there; the widow becomes a customer of the bank?

MR. MULHOLLAND: We have had some loans repaid, sir, within the hour.

THE CHAIRMAN: I hope you don't charge the customer for the advantages of these policies!

COMMISSIONER BROWN: This life insurance is always sublet?

MR. NEAPOLE: Yes, it is.

THE CHAIRMAN: Have you any view at the moment on the proportion of assets that you might visualize would be invested in personal loans of this kind if the 6 per cent ceiling were removed?

MR. BOYLES: If I may answer the question in this way, Mr. Chairman, I would say first of all, it is a matter of individual bank policy to, let us say, fix a percentage of assets for this particular type of loan, but I think it is fair to say that we expect some further growth in this type of lending. Of course, the very fact that you have, or could have, a substantial volume of this type of business on your books that sees quite a substantial cash flow coming in from the regular monthly installments also provides the funds to make fresh loans. It depends entirely, of course, on the demand. It depends to some extent, too, perhaps, on the availability of funds and the ability of the banks to compete with the other lending institutions.

MR. WADSWORTH: May I add a word, Mr. Chairman. You mentioned figures a moment ago, and I think you were looking at the Bank of Canada statistics of the increase in personal loans. It should be pointed out, I think, that it has been a very marked increase, as you have said, but although the personal loans of the banks are included in that total the total includes all loans to individuals not otherwise secured, so quite a percentage of those are not under any personal loan plan or are being carried by a branch at the regular rate.

THE CHAIRMAN: Yes. We have had a number

of representations from interested parties who claim that the cost of these personal loans should be disclosed and expressed as a definite interest rate. It is said that at the present time there are various ways of showing the cost of a loan in the documents of finance companies that cover the transactions, and the view that has been expressed before us on a number of occasions is that this cost should be translated into a percentage interest rate. Have you any views on that subject?

MR. MULHOLLAND: Perhaps Mr. Dixon could answer that question.

MR. DIXON: Generally speaking, I think it would be the case that the banks have no major objection to expressing the charge levied for installment credit loans as a simple annual interest rate.

THE CHAIRMAN: Or to rolling into that rate any finance charges there might be?

MR. DIXON: The total cost of the loan.

THE CHAIRMAN: Yes, the total cost, in other words.

MR. DIXON: Yes.

THE CHAIRMAN: Is there any mechanical difficulty in the way of working out the formula?

MR. DIXON: Yes, that has been the subject of much discussion, and I think it is, perhaps, the stalling point in the matter. It is difficult to find a universal or uniform basis covering all the charges that are added in, and expressing them all as one simple annual percentage.

THE CHAIRMAN: There is another question I would like to raise. It is not quite in the same category, and unless there are further questions in regard to personal loans I will ask it. I want to raise the question of over-drafts. We understand there has been a change in the attitude of the banks towards over-drafts. Perhaps I could ask you to give an explanation of this. Would you give us the background of, and the justification for, the change in a practice which was a well established one in the banking system of this country for many years.

MR. BOYLES: Mr. Chairman, the practice of lending by way of over-drafts might, of course, be regarded as an archaic practice. It grew up in banking in Canada, and it probably stemmed from the fact that this type of lending was permitted by the British banks.

This has been a problem that has been confronting the banks for many, many years, and it is only recently, of course, that they have done much about it, although it is safe to say that throughout the years the bankers have endeavoured to discourage their clients from borrowing in this form. These are, perhaps, the main reasons why.

The first reason is that the bankers definitely lose control of, first, their lending policies. They lose control of the respective accounts. There is the added feature that it involves a very substantial task in as much as when borrowers procure their funds in this form there is a very, very definite debit float, and that is sometimes, I think, not

recognized by, perhaps, the casual borrower.

It also has the effect of depriving the bank of what it should have in the form of creditor balance in order to provide it with proper compensation for other services. There is also the fact that the costs of handling this type of lending are excessive when compared with lending in the conventional fashion. This will become, perhaps, more apparent with the introduction of electronic processing equipment in as much as it interferes with this operation which is designed to make for more efficiency.

Indeed, here is a point that might be recorded, that the more efficient a bookkeeping system becomes, whether it pertains to loans or deposit entries, it is reasonable to assume that the costs to the customers will not be increased to the same extent. In other words, there could be some benefit to the customers due to the fact that the costs could be held down a bit, and certainly stopped from going upwards.

Lastly -- and this might not be fair to all types of borrowers -- it has the effect of encouraging people to project their requirements a little better instead of, perhaps, leaning on the banks more and more to perform some of their bookkeeping services.

COMMISSIONER LEMAN: Well, Mr. Boyles, with respect to the first point you mentioned, that of loss of control, to what extent is that true if all overdraft type of lending was done strictly pursuant to a line of credit arrangement limiting the amount of overdraft that any customer could use?

MR. BOYLES: If a line of credit were authorized in that form then the point I made about the loss of control would not apply?

COMMISSIONER LEMAN: It would not apply?

MR. BOYLES: That is right.

COMMISSIONER LEMAN: I am a little puzzled also about the reasons. If this is terribly hard to understand then I will not ask you to explain it here, but I do not understand why this would interfere with electronic processing systems. Certainly those systems must be flexible enough to accommodate this type of thing, must they not?

MR. BOYLES: Yes, to some degree. To some extent the electronic processing system is basically a speeding up operation, and in the course of employing equipment of this type it is expected that a good deal of this type of bookkeeping will, perhaps, be done at hours other than those that are regular office hours. It can be foreseen that in the middle of the night all of a sudden a certain number of cheques could come through that would have the effect of creating over-drafts, and that might happen at a time when there is, perhaps, nobody there to provide the proper authority to permit the borrowings in that form. In other words, there is an interruption in the proceedings.

Also, the possibility of centralizing a lot of bookkeeping operations is being considered. Here again, you can see that perhaps at a downtown location in Montreal or Toronto where the bookkeeping is being done for, maybe, 60 or 100 or more branches, that if

all these over-drafts that were being created in the operations of a branch bank which was 60 miles away, possibly, would create a problem.

COMMISSIONER LEMAN: I suppose a good programmer would solve that, but let us talk about the relative costs of that form of lending as against the cost of the conventional form of lending, as I will call the other one. Can you give us some figures which would indicate what the relative costs are, or what the relative revenues from the banks' point of view are?

MR. BOYLES: I know that I cannot give you any specific figures, but there are a few obvious things that I might mention. If a customer comes in and establishes a line of credit he automatically makes known his need and he gets his advances pursuant thereto. It is just a normal operation, but if a cheque comes through for which there has been no provision made then the young lady who is posting the ledger has to refer it to a senior officer who has the power to make loans, and obviously there is a time factor involved in all of this.

As I mentioned earlier, there is the debit float factor, which is an obvious added cost.

COMMISSIONER LEMAN: Certainly you must have some rough idea of the difference in the yield to the bank as between the two systems.

MR. BOYLES: May I refer again to the debit float factor. Let us assume that a client has a cheque which is cashed in Vancouver on his account in Toronto two days before it hits his account in Toronto, and he

had no funds in his account on the date the cheque was presented and paid in Vancouver. You are then in the position of having lost, let us say, the prime rate of interest in respect of the day or two that elapses pending the finalization of the transaction in Toronto.

COMMISSIONER LEMAN: That could be met by this system of charging back.

MR. BOYLES: Yes, it could be, and this is under consideration. That is being done now to some extent.

COMMISSIONER LEMAN: So this float problem is not inherent to the type of lending?

MR. BOYLES: No, but it is a fact now. In other words, under our present procedure there is a costly element in the debit float.

COMMISSIONER LEMAN: It is not possible to arrive at an approximate figure? If we use an anchor like 6 per cent then the different yields to the bank under either system could be calculated?

MR. BOYLES: It could be determined, but not in terms of a percentage factor. It could be determined in respect of the debit float, but after that it becomes a matter of time studies.

COMMISSIONER LEMAN: It would help if we could get an idea of the order of magnitude in terms of interest rates; as to whether the difference is one-half per cent or three-quarters per cent.

MR. BOYLES: We may be able to produce some statistical data on that.

MR. LORENZO HEBERT: May I say a word here?

Now, I think the cost would vary from case to case. If you have a customer that has one cheque one morning then the cost involved may not be too large, but if you have a customer, as we often have, that will have 25 or 50 cheques in a morning for which there are no funds in his account, then you have to process these cheques and you have to hold them back until he comes in and makes a deposit. You do not know whether you should pay them, or not. These are the cases where tremendous costs are involved sometimes. They are a great inconvenience. They will stop the work in the office, and this has proved very, very costly.

THE CHAIRMAN: Does not that apply also to the line of credit issued to a company?

MR. LORENZO HEBERT: It would apply. The unfortunate part of this is that if you have some account which you are able to give a line of credit, or in respect of which you grant over-drafts like that, then you will find your other customers coming in and claiming that their accounts should be overdrawn too. This is where we get into trouble.

THE CHAIRMAN: That is, if they overdraw beyond the limits of the line of credit, but that is an entirely different matter. If those people over-draw to that extent and in that way then that is a different thing entirely.

MR. LORENZO HEBERT: Yes, but there will be other people who will have no authorized credit who will have cheques coming in all the time that will over-draw their accounts.

COMMISSIONER BROWN: Can you not overcome that by having definite overdrawing privileges? Could not the people who have credit have to sign for it?

MR. LORENZO HEBERT: It is very hard, customers being what they are, to draw a line and say that this customer will be entitled to an over-draft and this customer will not be entitled to an over-draft.

COMMISSIONER BROWN: But you make this distinction now when you say you will grant a line of credit to this man but not to that man. You make the distinction now, do you not?

MR. LORENZO HEBERT: Of course, when he comes and gets the loan he has to make arrangements before-hand.

COMMISSIONER BROWN: I am assuming that these people will come in and make arrangements ahead of time.

THE CHAIRMAN: Of course, if they do not make arrangements ahead of time, and just overdraw with-out being entitled to overdraw, I do not know why you have to worry about them. Let them go to some other bank -- or, perhaps, they are your best customers?

COMMISSIONER LEMAN: How about a standby charge on a line of credit on an overdraft system? How much would the standby charge have to be?

MR. BOYLES: A standby charge in respect of an over-draft system would only be another complication if lines of credit were established for over-drafts. The same thing, of course, pertains to lines of credit in respect to availments that are evidenced by promissory

notes. Is your question: What is the attitude of the banks in respect to a standby charge in respect of any type of borrowing?

COMMISSIONER LEMAN: Yes.

MR. BOYLES: The answer is that normally the banks would like very much to have a standby fee because, firstly, they feel they are entitled to a standby fee for the commitment or the standby arrangement, but in practice it does not work out that way because in the first place if we were to apply or impose a standby charge we feel we would have a contractual obligation in respect to the line of credit.

Further, it has some other added problems. Clients come in and establish a line of credit -- let us be specific and suppose somebody comes in asking for credit up to $1 million because he has projected his requirements to that amount. If we were to apply a standby charge we feel that some might be inclined merely to make application for the loans as and when they need them thus creating a collossal administrative expense. In other words, everytime the customer wants money you have got to deal with it, whereas underlying it the drawings they make are automatic.

COMMISSIONER LEMAN: I was trying to get at the relative costs of the two systems by asking you what the standby charge would have to be to give the same result to the bank interest rate-wise.

MR. NEAPOLE: I think, if I may interject here, that one of the most difficult things about the overdraft system is, in most cases, its complete un-

predictability. It is true that you might have some customer coming in, as Mr. Boyles has said, and arranging an important line of credit, and that you have no difficulty with those people. Ordinarily you might not have any difficulty with those people anyway. But, there are so many unpredictable accounts upon which cheques are written from time to time which are overdrawn once or twice a year. Other accounts are habitually overdrawn. In many, many cases this involves telephone calls asking them to come in to cover up these amounts. You cannot leave an account overdrawn indefinitely. The customer is expected to make some arrangements.

Let us say for sake of illustration that one of your good customers, an executive of an important company, writes a cheque for, say, $10,000, and the account is overdrawn. You would normally expect him to come in and see you and make an arrangement. You call him about the cheque and this causes an argument between you. He says, "Why are you calling me? Am I not good for $10,000?"

The overdraft is completely unpredictable and is very difficult to handle. You have no idea of the strange situations it can create and how this affects your costs.

There is the other type of customer who is habitually overdrawn and who calls the branch perhaps six or seven times a day to inquire what cheques are in; then he scurries around to try to find the money to cover them. In the meantime we don't know whether he is going to find the money, and we have a constant problem. In the end the manager does overdraw the account and has to worry about collecting it later. This is not as easy a matter as running through your accounts and saying, this one is good for $100, this one is good for $5,000. That is too great a simplification of the matter.

COMMISSIONER BROWN: If the customer signs for it ahead of time, what is the difference?

MR. NEAPOLE: In that event you have a maturing obligation; you have a note of some

description. If it is a demand note you ask the customer what his arrangements are going to be. You may tell him to charge to his account $100 a month to pay off this obligation. On the other hand, if it is a businessman -- I mean a man whose overdraft is associated with his business -- he will have some system of cash flow, if he is an orderly person.

I have actually had people say to me that they were pleased about the elimination of the overdraft system -- believe it or not.

COMMISSIONER BROWN: Is that the whole quotation?

MR. NEAPOLE: You can take it as the whole quotation.

They have actually said to me before we did away with this system of overdraft, that in their own offices people went to the treasurer and had him write out cheques. Now they have to go to the cash book to know what they are doing. In this way the businessman was a lot happier about it because he felt he had control within his own office, which did not exist before.

MR. BOYLES: There is another point, if I may interject. This is important with respect to the question raised about why not give a line of credit for an overdraft. Some of these problems do exist. In other words, it would be automatically up to the limit of the line of credit. But the problem is, when you permit an overdraft you have

no evidence of obligation - you have given up everything. Some customers get their cheques daily, others get them monthly. But the fact is you have no evidence.

There is another point, and this is not related to my first assertion. It can be shown that the overdraft lending is responsible for quite a noticeable percentage of doubtful loans that creep up on the banks.

COMMISSIONER BROWN: Now perhaps we are getting the real answer. Mr. Boyles, that is very helpful.

MR. PATON: May I suggest something with respect to Mr. Leman's question about lending control being destroyed? In this respect may I say that the amount of the line of credit is only one factor of the matter of credit.

These lines of credit are usually generous in relation to the company concerned. I might interject that the majority of our overdrafts have to do with business loans. Perhaps the most vocal objection to them has been from the personal angle; by and large, it was overdraft borrowing and business loans. These lines of credit are set up on a specific basis. For example, there may be an authorized line of credit of $100,000 against X dollars of receivables. Now, when we permit them to borrow by overdraft, they borrow up to the amount of their line of credit, but there may be outstanding 5, 10 or even 20 per cent

of that amount in cheques already issued. It is the presentation of these cheques that results in the falling off of the collateral position, and the inability to meet the terms of credit. But as I say, the terms of credit are twofold, not only as to amount, but also in relation to the specific securities under our normal banking requirements.

COMMISSIONER LEMAN: The banks certainly are patient. How long did you suffer under the overdraft system?

MR. MULHOLLAND: Perhaps 150 years.

I have one comment, Mr. Chairman, about the individual complaints you have mentioned.

THE CHAIRMAN: I mention them only in a very general way. Perhaps I do not hear them, except the occasional one.

MR. MULHOLLAND: The complaints that have come to my attention relate to the cutting back in the line of credit. The first line of credit is the line arranged with the manager; the secondary line of credit is one they arrange for themselves. For instance, a business with a line of credit on an overdraft basis of $25,000, quite conceivably the treasurer of that company could so delay the mailing of his cheques in payment for goods until some long weekend, covering perhaps $5,000. In those circumstances he is in effect taking upon himself a line of credit of $30,000, because there are $5,000 worth of cheques in the banking system somewhere.

COMMISSIONER BROWN: This applies in any event, does it not?

MR. WADSWORTH: May I add a comment here? As I understood your question, you were thinking of the large, undoubted borrower - why can't he arrange to borrow this way, and what would be the fee for doing so?

COMMISSIONER LEMAN: No, I did not refer to the large borrower particularly.

MR. WADSWORTH: The undoubted borrower.

COMMISSIONER LEMAN: All I am trying to get at is this: Perhaps the banks would be quite right in saying they will not allow overdraft borrowing without a client having made arrangements to permit such overdraft. I would have no criticism of that.

MR. WADSWORTH: You raised the question, if that was done and if there was an added cost on the overdraft, what would you have to charge the customer?

COMMISSIONER LEMAN: Yes.

MR. WADSWORTH: I think the question, rephrased that way, could be answered by saying that there is a cost involved. We don't think it unreasonable when a customer issues a cheque that he should have funds in the bank to cover it; and I don't think that the cost of carrying those funds in the bank for the customer would be any greater than any charge, if we could possibly arrive at such a charge to the customer for borrowing through

the overdraft route rather than on a straight basis. In feeling that it would be no higher, it does simplify the process from the bank's point of view and keeps the overall costs down, which have to be borne by someone.

COMMISSIONER BROWN: Is it fair to say that this problem was not the same when the prime rate was 4½ per cent, rather than since the prime rate has been nudging the 6 per cent?

MR. BOYLES: The problem is already there. Normally, we would superimpose a penalty charge on the rate charged to the customer; that would be a half of one per cent over the rate charged. There is an added problem when the prime rate is 6 per cent; in other words, we lose any opportunity of imposing that penalty.

COMMISSIONER BROWN: I am just flying kites here, which I enjoy doing. For instance, if the interest rate ceiling were lifted and your prime rate was still 5 3/4 per cent -- there are suggestions in certain places that it might be even lower -- and you arrange that people come in first and sign ahead of time to have an overdraft privilege at 7½ per cent ---

MR. BOYLES: What do you mean by "sign ahead of time"?

COMMISSIONER BROWN: Come in and make their arrangements ahead of time; sign a form; it would not be a note because they are not borrowing a specific amount. They would sign a form under

which they agree that if an overdraft occurs up to, say, $5,000, they would pay at the rate of 7½ per cent.

MR. BOYLES: It still does not remove all the administrative and handling difficulties.

COMMISSIONER BROWN: What we are trying to get at -- and this is getting back to Mr. Leman's point as to what these consist of -- what is the rate differential that would come into the picture?

MR. NEAPOLE: As a partial answer, may I say when I came into the bank many years ago the rates on overdrafts were high, but they were still regarded as the same headache by the managers, despite the compensation at that time. This was before the 6 per cent days.

COMMISSIONER BROWN: We are thinking about this on the basis of an arrangement being made ahead of time.

MR. NEAPOLE: Yes.

MR. BOYLES: You still lose control of the account on occasions where an arrangement is not made.

COMMISSIONER BROWN: We are presupposing that an arrangement is made. I do not see that you would have any more loss of control, if I made an arrangement for credit of X dollars on February 15, and then I say I want this line today. I do not see that there is any more control or any less control in that situation.

MR. BOYLES: The bookkeeping and administrative problems are still there, regardless of what extra fees or interest cost you may impose.

THE CHAIRMAN: Perhaps your biggest customers are at times the most obnoxious, when they find they can't get away with things they are not entitled to.

COMMISSIONER BROWN: We can sum this up by saying that all bankers are against overdrafts in any form.

MR. WADSWORTH: We are not the only bankers. In the United States they have no overdraft system, and they operate effectively.

COMMISSIONER BROWN: How is it that in the United Kingdom they are able to operate on an overdraft system and apparently it works very well?

MR. WADSWORTH: I don't think in the United Kingdom there has been the same degree of payment by cheques as there has been in this country and in the United States.

COMMISSIONER BROWN: Have you not made a study of this question?

MR. LORENZO HEBERT: There would not be the same privilege of abuse on the part of certain customers.

THE CHAIRMAN: I would imagine if anyone abused the privilege over there he would hear about it and no other banker would be interested

[illegible]

[illegible] of what [illegible] that you are talking.

[illegible] concerns are [illegible] [illegible] are not [illegible].

COMMISSIONER [illegible]: [illegible] up by [illegible] in any form.

MR. MARSHALL: [illegible]

They [illegible] their [illegible].

COMMISSIONER [illegible]: [illegible] in the Uniform [illegible] on an [illegible] very well.

MR. MARSHALL: I [illegible]

COMMISSIONER [illegible]: [illegible] a study of [illegible]

MR. [illegible]: [illegible]

[illegible]

in him.

We will adjourn now until 2. P.M. this afternoon.

--- Luncheon Adjournment.

--- Upon resuming at 2 p.m.

THE CHAIRMAN: We shall now resume. With respect to the personal loans, to what extent do you feel that you can turn these on and off, as it were, with changing credit conditions? Can these be managed in an anti-cyclical way?

MR. BOYLES: Mr. Chairman, naturally the availability of money is a deciding factor in respect of turning this type of credit on or off, but we would like to think that even under periods of monetary restraint we can still serve this market in a reasonable and sensible way. I do not think that some credit restraint should have the effect of turning it off or on or in turning it off completely; nor do I think that we would like to contemplate engaging in this practice on the basis of being hot and cold. In other words, we hope to follow a general sensible policy as we try to in respect of other normal types of borrowings.

THE CHAIRMAN: Well, you simply carry on and if there is a demand for loans and if credit is available you supply it?

MR. BOYLES: Yes.

THE CHAIRMAN: With reference to the Industrial Development Bank, you have mentioned the competition which may to some extent be taking place as a result of the lending rate. The bank rate has gone up as high as 7 per cent, and apparently now it is approximately 6½ per cent. Is this a serious matter?

From your point of view do you feel that this is an objectionable invasion of the banking field?

MR. WADSWORTH: Mr. Chairman, I think the answer to that is "yes, to a degree". We feel that in a number of these cases the loans could have been entertained by the chartered banks if we had had the privilege of taking the same form of security and flexibility as to interest rate. Whereas the Industrial Development Bank was created to complement other forms of lending sources, it is not subject to the stipulations I have mentioned in the area of direct competition.

THE CHAIRMAN: You think that the sort of operations they carry on are in a field which you would be prepared to occupy if the ceiling on interest rates was lifted?

MR. WADSWORTH: Yes.

THE CHAIRMAN: Plus the change in security?

MR. WADSWORTH: Oh, yes. I am sorry. I missed that. Thank you. In other words, if the borrower is credit-worthy we should be able to provide the facilities if we have the opportunity to take the security.

COMMISSIONER BROWN: Do you think that under a term loan of a greater length than the Industrial Development Bank loan you would be able to compete with the I.D.B.? They are charging 6½ per cent.

MR. WADSWORTH: That is right.

COMMISSIONER BROWN: Where are you going to get in there on a competitive basis, at 6½ per cent?

MR. WADSWORTH: No. It would depend on the

general level of interest rates, Mr. Brown, but most of these borrowers have already a banking connection. It is natural they would discuss their requirements with their bank, and if it were an area where they could not go to the market then the banks would endeavour to look after that.

COMMISSIONER BROWN: I am endeavouring to find out what the real objection is? At the moment there is only a margin of one-half of one per cent on rate, isn't there?

MR. WADSWORTH: And security.

COMMISSIONER BROWN: Suppose you were allowed freedom of rates and freedom of security, what price are you going to take this at, 6½ per cent too?

MR. WADSWORTH: When the prevailing rates were 6½ per cent I think that would be the rate, yes. I am not trying to evade the question, for I know that interest rates vary a great deal and there could be times when it would be much less than that and times, in the case of the Industrial Development Bank, when it would be much higher than that. The markets in other areas would be a determining factor.

THE CHAIRMAN: Do you think the Industrial Development Bank rate is lower than it should be in view of its position in the market as a lender of last resort?

MR. WADSWORTH: There is always a danger, Mr. Chairman, that a fixed rate such as that could be lower, but I think each individual case would pretty well have to be judged on its merits, and also in the

[illegible] of their [illegible]

It is [illegible]

with their [illegible]

[illegible]

COMMISSIONER [illegible]: [illegible]

out when the [illegible]

only a margin of [illegible]

better?

MR. [illegible]: [illegible]

COMMISSIONER [illegible]: [illegible]

freedom of [illegible] and [illegible], what would

are you going to [illegible]

MR. WALKER: [illegible]

were 6½ per cent I think [illegible]

I am not [illegible]

interest [illegible]

[illegible]

in the case of [illegible]

to [illegible]

other [illegible]

[illegible]

[illegible]

[illegible]

MR. [illegible]: [illegible]

Mr. Chairman, [illegible]

lower, [illegible]

light of what borrowers, probably the larger borrowers, were obtaining on the market.

THE CHAIRMAN: Perhaps you could not tell until the ceiling interest rate was raised?

MR. WADSWORTH: I do not think we could. There is another factor in the competition with the Industrial Development Bank, and that is that they have not been subject to the monetary policy to the extent we have in the availability of funds for granting loans.

THE CHAIRMAN: Yes. I notice you have mentioned that here.

COMMISSIONER BROWN: One of the biggest problems in looking at the operations of the Industrial Development Bank is this one of "reasonable terms and considerations". In other words, the I.D.B. is able to enter the field under their own regulations, provided the credit is not available from alternative sources on reasonable terms and conditions. Now, how would you interpret this?

MR. WADSWORTH: If I understand your question correctly, and you are relating it to what we have said, that we would like to have freedom to compete in the same area?

COMMISSIONER BROWN: That is right.

MR. WADSWORTH: There might well be areas in the judgment of the management of the Industrial Development Bank where they would like to go further as to term or lower as to rate, or some differential as to security, than what a bank would like to do.

what we are saying is we think we should be able to be competitive when it suited us to do so.

COMMISSIONER BROWN: That was pre-supposing a situation. What sort of basis do you consider this "reasonable terms and conditions" applies under today's circumstances? This is asking the banks to give an objective picture, for this is pre-supposing that the banks are not competing. We ran into problems from other people in the private sector who say that the Industrial Development Bank is competing unfairly.

MR. WADSWORTH: I am afraid I have not quite got the significance of your question, Mr. Brown. You are saying "under present conditions".

COMMISSIONER BROWN: We are talking about the other people in the private sector who are at the moment complaining about the Industrial Development Bank competition, and I would just like to know whether you have an opinion on this.

MR. WADSWORTH: As far as other lenders are concerned?

COMMISSIONER BROWN: Yes.

MR. WADSWORTH: No.

COMMISSIONER LEMAN: May I ask the question this way? Suppose the 6 per cent ceiling were removed and the banks were enabled to take security on immovables, do you think there would be any more justification in the field left for the I.D.B. at all?

MR. WADSWORTH: I think there might be a field left, Mr. Leman, for the Industrial Development Bank, but I do not see how a banker could necessarily

[illegible]

[illegible] ability [illegible]

[illegible]

a situation. [illegible]

Expenditure cause and [illegible] supplies [illegible] country's

circumstances. [illegible] to give an

economic picture, [illegible]

banks are not competing. [illegible]

other people in the private sector who say, the

Individual Development [illegible] is competing unfairly.

MR. [illegible] I [illegible] I have not quite

got the significance of your question, Mr. [illegible] You

are saying 'unfair [illegible]'.

COMMISSIONER [illegible] We are talking [illegible]

the [illegible] in the private sector [illegible] of the

[illegible] complaining about the Industrial [illegible]

competition. I would just like to [illegible]

have an opportunity [illegible]

MR. [illegible] I [illegible]

[illegible]

COMMISSIONER [illegible] Yes.

MR. [illegible] Yes.

COMMISSIONER [illegible] I ask the question

this way: [illegible] if you were getting your reserves

and the banks were [illegible] responsibility [illegible]

economy, [illegible]

[illegible]

MR. [illegible] I [illegible]

[illegible]

answer that. It would depend on the judgment and policy of the Industrial Development Bank as to how far they wanted to go. The point I mentioned a moment ago as to the availability of money would have a bearing. If we were operating under quite stringent monetary conditions, then obviously term loans would have to be looked at very carefully. The purpose would have to be carefully examined, and the lender who was not subject to those restrictions as to the supply of funds might well under these conditions be willing to entertain a loan that a bank would not.

COMMISSIONER LEMAN: You know what kind of loans the Industrial Development Bank makes in general?

MR. WADSWORTH: Yes.

COMMISSIONER LEMAN: And you know what its business is. What I am asking you is this. Presupposing these two conditions you have mentioned as being necessary to make you competitive, do you believe the banks could pretty well handle all the business the Industrial Development Bank has handled?

MR. WADSWORTH: I believe that generally speaking, on or about the same length of terms and that sort of thing, we could.

MR. BOYLES: I would like to raise a point. In my opinion there is still room for the Industrial Development Bank if it were to continue to operate under its original terms of reference. In other words, it was a lender of last resort. If some client proved to be a non-desirable applicant or could not meet the requirements of a banking institution, the Industrial

around that [illegible]

of the [illegible]

wanted to [illegible]

to the [illegible]

We were [illegible]

considerable [illegible]

[illegible]

[illegible]

to these [illegible]

[illegible]

a [illegible]

[illegible]

[illegible]

MR. [illegible]

[illegible]

October [illegible]

supported [illegible]

being [illegible]

the [illegible]

[illegible]

MR. [illegible]

[illegible]

[illegible]

MR. [illegible]

in my [illegible]

[illegible]

[illegible]

words, [illegible]

[illegible]

Development Bank was to serve in the capacity of the lender of last resort in such circumstances. I still think they can function in that fashion.

COMMISSIONER LEMAN: Well, if you can get any security you want, lend for any term you want and at whatever rate you want, and there is no ceiling on interest rates and you can get any security you want, is there any borrower who would not be a worthy credit for the banks that would be a worthy credit for anybody?

MR. BOYLES: Well, under the original terms of reference I suggest the Industrial Development Bank would assume risks that perhaps the chartered banks would not be so inclined to do.

COMMISSIONER LEMAN: I thought there was a price on any risk?

MR. BOYLES: Their rate is a little higher.

MR. MULHOLLAND: They might follow a different role in that the loans they make now of a banking nature, as Mr. Wadsworth has said, could be taken care of by the chartered banks under certain conditions, and the operations of the Industrial Development Bank might then revolve around investment in the equity field, in the acquisition of equity in new companies or old companies requiring additional capital which could not be found in any other source.

COMMISSIONER LEMAN: Well, you are suggesting, therefore, that where the market, given the complete freedom, where the private institutions, given the complete freedom, do not handle a market properly and is not likely to handle the market properly and would

not satisfy the demand, then the government should step in and make sure it provides the right kind of competition to satisfy these needs?

MR. MULHOLLAND: Yes.

COMMISSIONER LEMAN: Because I thought the excuse for doing these things - I thought I had read in here that the reasons for the existence of these things were that there were impediments to the banks and other institutions in being able to handle the business demand - certain kinds of demands - probably because they were too inhibited in their own powers, you see.

MR. WADSWORTH: That is what I wished to convey in my answer, Mr. Leman.

COMMISSIONER LEMAN: Would it not, therefore, make sense to take the reverse proposition and say that if the private institutions, all of them, were not inhibited by any restrictions, that presumably the demand should be satisfied?

MR. PATON: I think the one inhibition that you cannot remove is the inhibition of terms in relation to the disposition of the assets of the banks. These capital loans are generally, for expansion purposes, repayable in accordance with the earnings of the individual company making the loan, and if the term of repayment is beyond its power, within the region of what the banks would wish to make the term loans, then they may have to go to a longer term institution, which may be the Industrial Development Bank or some alternative lender. So I would associate myself with Mr. Boyles very definitely that there is room for the

continuity of government bank lending in this field, notwithstanding the movement of any individuals to the banks as far as rates or securities are concerned.

THE CHAIRMAN: Would you care to comment on the function of a corporation such as ROYNAT?

MR. NEAPOLE: I am a director of ROYNAT so I do not know which hat to put on.

THE CHAIRMAN: Keep that hat on for the time being.

MR. NEAPOLE: The bank hat?

THE CHAIRMAN: Is that a corporation which is in a position to make the sort of loans that the Industrial Development Bank makes?

MR. NEAPOLE: Broadly put, yes. We have often been asked if we compete with the Industrial Development Bank, and I think that in any kind of borrowing there is bound to be some fringe competition.

[illegible] of [illegible] being [illegible] in this Board, [illegible] of [illegible] of the [illegible] of [illegible] of [illegible].

THE CHAIRMAN: [illegible] the [illegible] of [illegible] question [illegible]?

MR. [illegible]: I [illegible] of [illegible] so I do not know [illegible] to [illegible].

THE CHAIRMAN: [illegible] all on the [illegible] being.

MR. [illegible]: [illegible]

THE CHAIRMAN: [illegible] as in a [illegible] [illegible].

MR. [illegible]: [illegible]. We have often been asked if we [illegible] the [illegible] Development Fund, [illegible] of continuing there [illegible].

I would say, though, in the broadest sense we probably do not compete with them directly. They do a broader type of lending which is primarily that of purchasing the securities accounts, debenture issues, and so forth.

THE CHAIRMAN: Well, in what manner do you enter the field?

MR. NEAPOLE: Well, it is ---

THE CHAIRMAN: Have you gone far enough yet to establish a regular practice?

MR. NEAPOLE: We have gone far enough to establish a regular practice, but how that will work out will have to be seen. I think I can say this much, that it is doing very well.

THE CHAIRMAN: What I would like to get at is, is it conceivable that there are institutions such as ROYNAT that would be able to lend at a price to the extent that the demand for that sort of capital would be met, reasonably met?

MR. NEAPOLE: Well, categorically, yes. Now, to the extent that they are able to acquire money for the purpose of engaging in this business, and all the rest of it, that would be one of the limiting factors, the chief limiting factor. They would have to find the money privately.

THE CHAIRMAN: As I understand the I.D.B., it is intended to fill in the gap between the institutions which can lend money and make a profit, and the further situation where it may be desirable for a company to be allowed to proceed, even though it cannot borrow on economic terms?

MR. NEAPOLE: I am not just sure that I get that question, sir.

THE CHAIRMAN: Well, what is the purpose of an institution such as the I.D.B. if it is merely doing the same sort of thing on a regular commercial basis that can be done by existing institutions that are competing in the financial world, and running at a profit or hoping to run at a profit?

MR. NEAPOLE: Well, of course, to go back to Mr. Boyles' remark, the initial purpose of I.D.B. was to provide a lender of last resort, if the borrowings couldn't be found elsewhere on reasonable terms and conditions.

THE CHAIRMAN: Well, do "reasonable terms and conditions" include the situation which might be described as uneconomical?

MR. NEAPOLE: For the lender?

THE CHAIRMAN: Yes?

MR. NEAPOLE: Oh, I wouldn't say that that would be reasonable if it was uneconomic for the lender.

THE CHAIRMAN: If it is not uneconomic, why can't a lender be found other than the I.D.B.?

MR. NEAPOLE: Well, the lenders can be found at a price.

THE CHAIRMAN: That is what I mean.

MR. NEAPOLE: Yes, as a rule.

THE CHAIRMAN: Is there justification for an investment institution to lend where the money cannot be found at a price?

MR. NEAPOLE: Well, I would say yes. I have frequently worked with I.D.B. in different situations, and I have found them fulfilling a very good function.

COMMISSIONER GIBSON: I think that one of the original ideas of I.D.B. was to fill in the gap that was believed to exist between the area which the banks could cover, particularly with regard to terms, and the area that the capital market could cover, particularly with regard to size, and with particular reference to smaller businesses.

Now, I think another way of putting the Chairman's question might be to say, do you think that gap is being filled in to a significant degree or is filling in at a significant degree?

MR. NEAPOLE: Well, I would say yes, but not completely because it doesn't provide, let us say, the same capital outlays that other institutions might provide, like ROYNAT, for instance, so it is a question of the term and the acceptability, and so forth. That was why I said before I didn't consider that ROYNAT competed directly, necessarily, with I.D.B. and certainly not to, say, an important extent.

THE CHAIRMAN: Yes, but as long as there are institutions that are doing that sort of business at a price, which is the market price and at the market level, whatever that may be, is there justification for an investment institution to do the same sort of business at less than the market price?

MR. [illegible]: [illegible]

that [illegible]

something [illegible]

very good question

[illegible]

of the original ideas of [illegible] was to fill [illegible]

gap that was believed to exist between the [illegible]

which one bank would [illegible], particularly [illegible]

to terms, and the area where the [illegible]

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particular [illegible] for smaller [illegible].

[illegible] I [illegible] of putting the

Chairman's question might be to say, do you think

that gap is being filled [illegible] significant degree

or is filling in at a significant degree.

MR. [illegible]: [illegible], I [illegible]

but not completely because [illegible]. If

we say, the same capital [illegible]

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it is a question of the [illegible]

and so forth. That was why [illegible]

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[illegible].

THE CHAIRMAN: Yes, but as long as there

are institutions [illegible]

at a price, which is the market price, and at the

market level, whatever that may be, [illegible]

for an investment [illegible]

MR. NEAPOLE: That is a very difficult question to answer. As I said before, I have seen many cases where they filled a very valuable function, and whether or not --

THE CHAIRMAN: That may have been at a time when there were no institutions designed to fill that particular gap?

MR. NEAPOLE: That could be.

THE CHAIRMAN: But if there are now institutions that can fill the gap, even though they may fill it at a somewhat higher cost to the borrower than the I.D.B. has done, nevertheless is there justification for, in effect, almost subsidizing certain undertakings?

MR. NEAPOLE: Well, I suppose you could interpret it that way, but the way we look at that, partly, is this; there is a specific type of financing that suits several different occasions, let us say, and I.D.B. provides one type of -- let us say one fills one gap and the finance companies might fill another gap and ROYNAT might fill another gap, but I wouldn't say they are all identical, necessarily.

COMMISSIONER BROWN: Let us get back to this lender of last resort when adequate credit is not available on reasonable terms and conditions. If I.D.B. is prepared to lend at 6½ per cent and somebody else is prepared to lend at 8½ per cent, is the I.D.B. functioning properly?

MR. NEAPOLE: Well, I think that the I.D.B. itself has made it perfectly clear that they

always investigate these situations and they will not take on loans unless they have been turned down; as I say, unless they have been turned down by other people.

COMMISSIONER BROWN: But there is this problem of reasonable terms and conditions.

MR. NEAPOLE: It is a problem, I agree.

COMMISSIONER BROWN: The finance companies have been complaining that they are prepared to lend money to these people, and I.D.B. comes along and does it instead?

MR. NEAPOLE: That is right.

COMMISSIONER BROWN: And you usually find that there is a difference in rate and a difference in term, but what I am trying to get at is is there any way of putting a measurement on this, of measuring the gap that has to exist in order to say that these terms are not reasonable?

MR. NEAPOLE: Frankly, I wouldn't want to say it. I know not so long ago I.D.B. made some kind of a public statement, and I have just forgotten what it was, the exact terms of it, but it was to some extent in refutation of the claim made by a lot of people that were not acting as a lender of last resort that they were infringing on private enterprise too much, and so forth, and I am not sure whether it was the Governor of the Bank, or who it was, but he made a public statement of some description not too long ago about that very point, and I don't know what the words were.

COMMISSIONER BROWN: I gather you consider that if the banks are given greater freedom of action on rates and securities that the gap, such as it exists, would be considerably narrower?

MR. WADSWORTH: Yes, that is my view and, of course, subject to the availability of funds.

THE CHAIRMAN: There is one question which I would like to ask about this. You say in one place that equities are foreign to the main purpose and nature of a commercial bank; that is in relation to the assets of the commercial bank. I understand the banks are not accustomed to dealing in equities, but why are they so foreign to the main purpose? Is there no place for equities in a bank portfolio?

MR. MULHOLLAND: I will put it this way, Mr. Chairman; that it would not be right to say the banks have never acquired any equities in the past, or that they may never acquire them in the future, but our brief in paragraph 84 holds the view that investment in equities is foreign to the main nature and purpose of a commercial bank.

To repeat again, the banks regard their primary role as one of support through lending rather than that of taking the position of a part owner of a business and taking on the risks attendant through the purchase of equities. In other words, the banks supplement the resources of risk takers by lending working capital funds, and also on occasion and to some extent by providing term capital.

The fundamental principle here, of course, is again our deposits, our funds which we owe to depositors and we must be prepared to pay them on demand, and it seems only appropriate that we should stand in a creditor relationship to borrowing customers or lending customers.

There might, indeed, arise quite a conflict of interest if the banks acquired a partial ownership in companies through equities. If the bank was also in the position of a lender for working capital purposes, presumably the equities any one bank might wish to have or might have full knowledge of, would be those accounts in which they were standing as banker. There could be quite a situation arise if a trend developed which indicated that their holding of these equities, where their investment in this company might be getting into a position of jeopardy and, as I repeat, this principle I have stated is not invariable. A bank may own equities from time to time to a very minor extent, but these situations are rare and isolated and the bank will find itself in the position of ownership of equities in a company where the company was getting in difficulties and a pledge of the shares in the company was essential for additional security for the bank's position on its current loan.

THE CHAIRMAN: Made by corporate securities?

MR. MULHOLLAND: Yes, made by corporate securities.

THE CHAIRMAN: Bonds and debentures, and that sort of security, but I suppose you regard equities as a little more risky than others, but on the other hand I am just wondering why you go so far as to say that they are foreign to the main purpose and nature of a commercial bank. I thought that even though it is advisable not to get into them too deeply ---

MR. MULHOLLAND: The position there might be, Mr. Chairman, that ---

THE CHAIRMAN: Aside from any conflict of interest, and that is the point that makes it a little difficult, but I think merely as to the value and the possibility ---

MR. MULHOLLAND: Generally speaking our investment holdings, our provincial and municipal and corporate holdings that we are discussing now, they should be of a fairly self-liquidating nature, preferably on a serial basis. We are not locked in and dependent upon future profits, which would be the case if we adopted the equity position, and this revolves back to the question of the banks' requirement that they must be as liquid as possible in all circumstances.

COMMISSIONER HARROLD: I would like to ask a question here. We were talking about loans, and one section was on the government guarantee of loans. What is the bankers' general view on the use of the government guarantee? Would you have less in this field without the government guarantee? What has

been the experience in these particular loans? There are four areas mentioned here.

MR. WADSWORTH: I think, Mr. Harrold, we might have loaned less. It is questionable as to how much less. If we had been able to -- and I must come back to the previous subject -- if we had been able to take the security which under a number of these Acts we are able to take and which are not normally available to us. I think it is probably fair to say that the government guarantee -- in some areas the rate of interest has been lower than it would be without the government guarantee, because the risk has been reduced and almost eliminated. I think it is also important to point out in dealing with government guaranteed loans, particularly in certain areas, such as Farm Improvement Loans, that the banks have continued quite actively in that field in periods of tight money and in periods when other rates were considerably higher than we were getting on the Farm Improvement Loan ones.

COMMISSIONER HARROLD: Has the guarantee been justified by the losses experienced, or what would happen if there was a move at the present time to guarantee part of it?

MR. WADSWORTH: The losses have been quite small; I am speaking of the main guaranteed loans, but I think it would be fair to say without the government guarantee that the rate of interest would be higher.

COMMISSIONER HARROLD: How much higher;

equal to the loss percentage which has been experienced by the government because of the guarantee, would that be a fair way of putting it?

MR. WADSWORTH: No, I think a fairer way of putting it would be -- in the light of other interest rates that were prevailing, because your interest rate isn't geared entirely into the loss factor and the availability of funds -- what those funds may cost the lender.

COMMISSIONER HARROLD: There are different interest rates for all these different plans, are there not?

MR. WADSWORTH: That is right. I might not have all of these, but the current rate on farm improvement loans is 5 per cent; the current rate on home improvement loans is 6 per cent; on small business loans, which are relatively new, the rate is 5½ per cent.

COMMISSIONER LEMAN: At page 72 of your submission you give some statistics with respect to loans. The main ones are government guaranteed loans. These seem to have moved from roughly 8 per cent in 1954 to over 20 per cent in 1961. Have you any idea of what these loans represent in numbers as a percentage of the total loans. These figures are all in dollars, but I am wondering if you have any statistics on the basis of numbers of loans.

MR. WADSWORTH: I am not aware if we have those figures. I can inquire. Before answering your question I might say that while this percentage has increased, as you are aware, we are now including insured mortgage loans and they account for a very large amount. The change would not have been as great without those.

COMMISSIONER LEMAN: Would it be your guess that the loans made under these government sponsored programs in general are for larger amounts or smaller amounts than the general unguaranteed loans?

MR. WADSWORTH: A lot depends upon the type of borrower. The home improvement loans are for

relatively small amounts and are used for minor improvements, and they run up to larger loans. I do not know that the guarantee affects the amount of the loan so much as do the requirements of the borrower. Was that your question?

COMMISSIONER LEMAN: I did not mean it in that sense. I was trying to get a guess as to whether it is more than 20 per cent in numbers, it being 20 per cent in dollars.

MR. WADSWORTH: I have not that information in front of me, but some other general manager might have it.

THE CHAIRMAN: I do not know whether I can safely assume from what you have said that you would be in favour of this, but I will ask you: Would you be in favour of modifying the guarantee, and allowing the interest rate to find its own level in all of these guaranteed loans?

MR. WADSWORTH: No, that was not what I was endeavouring to say, Mr. Chairman.

THE CHAIRMAN: Well, would you say it now?

MR. WADSWORTH: No, although I think there would be certain social factors that enter into this and which are at the federal and provincial governmental levels. The decision as to the continuation of them rests largely with the federal government and the provincial governments. There is something in addition to that, and that is that I think that we would have to have the requirement as to security amended as well. But, in many cases, I think the facilities would be

available.

COMMISSIONER HARROLD: What is the limit of the availability of, say, the farm improvement loans? You suggest you are not too happy with the ceiling there, and yet we have had a representation to the effect that the money is not there. What is the limit that any one bank lends in respect to farm improvement loans? I think that is the biggest type of loan in terms of dollars.

MR. WADSWORTH: I can only speak for ourselves, but I do not know of any bank that has put a limit on the amount of the farm improvement loans. Our experience with them has, as I say, been quite satisfactory. I think they have filled quite an important function, particularly in the development of new areas and where new land is being broken -- land up north and in some of the prairie provinces and in many other fields as well. I do not think that the total has been such, as far as I am concerned, that it would cause any concern when compared with the total loan portfolio of a bank, but I can speak only for ourselves.

COMMISSIONER BROWN: With respect to home improvement loans where you have a rate of interest which is as high as it can go -- it is 6 per cent -- is there any explanation as to why those loans have been so static in amount. As shown in your brief these loans in 1959 reached a peak of $60 million, i 1960 they were down to $55.5 million, and in 1961 they stood at $66.1 million. The trend there is quite different from other bank figures.

MR. MULHOLLAND: We have often considered those figures, Mr. Brown, and wondered ourselves. A partial answer to it has been the development of these instalment finance loans in the banks in recent years. Strange as it may seem, we come back again to a life insured loan in respect of which the maximum insurance in at least one bank is $10,000. If a home improvement loan is required it is a very small additional price to pay by way of processing and service charges to put that loan under the instalment finance category instead of taking out a straight home improvement loan. That is only a partial answer.

COMMISSIONER BROWN: I would think so because, presumably, it is the case of the borrower paying a total of 9 per cent when he can get a home improvement loan at 6 per cent. In that case he is paying $30 per $1,000 for his term life insurance.

MR. MULHOLLAND: Which might be cheap, depending upon his age.

COMMISSIONER BROWN: Do you not have any young people who want home improvement loans?

MR. WADSWORTH: I think, Mr. Brown, it is very difficult to answer that because the banks for several years, in conjunction and collaboration with the federal government, have entered into special advertising campaigns in respect to the winter works program, and that sort of thing, in order to support the home improvement plan.

COMMISSIONER BROWN: People would rather

come in and pay 9 per cent instead of 6 per cent?

MR. WADSWORTH: No. I was trying to explain why the total had not increased.

MR. LORENZO HEBERT: If I may give a tentative explanation I would say that the fact that we have had so much new housing since the last war might account for there being less demand for these loans now.

COMMISSIONER BROWN: Do people have to have clear title before they can borrow on a home improvement loan?

THE CHAIRMAN: No. Do you think, Mr. Hebert, it is because there has been so much new housing recently and it has not yet reached the repair stage? Is that your point?

MR. LORENZO HEBERT: Yes, that is my point, and quite a number of old houses have been demolished.

THE CHAIRMAN: We still have a long way to go in that respect. Small businesses loans have not increased as rapidly as one might have expected in view of the fact that we hear a considerable amount of criticism of lack of facilities for small businesses. Is there any explanation of this?

MR. WADSWORTH: A partial explanation might be, Mr. Chairman, that the potential for these loans was not as great as was indicated by all the talk and conversation, and all the various other matters that related to them, before they were instituted. Also, if you are aware, under the Act, the banks are expected, and it is part of their requirements, to examine the creditworthiness of each borrower. They cannot take on

any loan that may come in. These are all small borrowers, and the managers in the outlying areas and even in the metropolitan centres keep in pretty close touch with the operations of that borrower. That bank manager's assessment of the straight creditworthiness of the borrower may be such in some cases that he thinks the loan should not be entertained. There has not been a large number of declines, but the applications have not been as heavy as those outside the banks thought they might be.

THE CHAIRMAN: There must be a large share of small borrowing that is done without guarantee at all.

MR. WADSWORTH: Yes, I think that is quite true.

THE CHAIRMAN: Do you think there is any real problem in this field of the small borrower? We hear a great many complaints from small businessmen who want to borrow and who have difficulty in getting the sort of funds they require. I am just wondering whether from your experience you can say that there is no real problem, or, if there is a problem, what it is.

MR. WADSWORTH: I do not think there is any real problem. There have been some procedural problems, and a number of suggestions have been made by the banks about routine procedures in the handling of these small business loans. One suggestion that has come up, but which would not affect the smaller small borrowers, is that the limit as to the annual volume of business or sales of $250,000 might be increased. Apart from that, and others that are of a routine nature and which I think

and other sources, [illegible]. There are 8.1 [illegible]
[illegible], and the [illegible] in the following [illegible] were in the [illegible] which [illegible] of [illegible] of the [illegible] and [illegible] a large number of [illegible] and [illegible] many [illegible].

[illegible]

Mr. [illegible]

[illegible].

[illegible] [illegible]

Mr. [illegible]

[illegible] and a number of [illegible] [illegible]

will be ironed out as we obtain more experience, and as the authorities obtain more experience with the problems that are arising, there is no real problem. These problems are purely routine.

MR. MULHOLLAND: There is a problem in one large area of the country that is well known to you. I am referring to the province of Quebec where we are unable to take security by way of chattel mortgage. That is mentioned in the brief.

COMMISSIONER LEMAN: How about the area of the financing of exports. Can you give us a brief run-down on what has been the experience of the Export Finance Corporation to date?

MR. BOYLES: Mr. Chairman, perhaps I could answer that. First of all it will be recognized that it is not a function of the Export Finance Corporation to develop business directly. It merely provides the re-discount facilities for the chartered banks. As is mentioned in the brief, I believe, the experience has been rather dissappointing, but it will be recognized that the facility is now generally known, and has been generally known, through the branch bankers, and the volume of capital goods which result in paper for re-discount with the corporation depends, of course, primarily on the efforts and the ability of the exporters themselves.

COMMISSIONER LEMAN: What has been the experience? How much has it loaned?

MR. BOYLES: At the present time the corporation has re-discounted paper to the extent of

some $115 million.

COMMISSIONER LEMAN: Are you satisfied with the way the E.C.I.C., under its regulations, has operated? All of these are insured loans, are they not?

MR. BOYLES: Yes. We have no observations to make about the provisions of the relevant legislation.

COMMISSIONER LEMAN: But it is your feeling that whatever demand there was has been satisfied?

MR. BOYLES: Yes.

COMMISSIONER LEMAN: Am I right in thinking that a lot of that business has turned out to be not Canadian dollar business?

MR. BOYLES: A lot of it is not Canadian dollar business. A lot of exports are in U.S. dollars. As a matter of fact, the paper under discount is usually expressed in U.S. dollars.

COMMISSIONER LEMAN: Therefore, if the re-discount is in U.S. dollars would the Export Finance Corporation finance itself in U.S. dollars to satisfy this demand?

MR. BOYLES: Yes. In other words, it looks to the markets for U.S. dollar coverage to provide for this facility, and it protects itself, of course, by buying forward, and so on.

COMMISSIONER LEMAN: There seemed to be such an outcry with respect to the financing needs of the exporters. Is it no surprise to you that no more business has been developed?

MR. BOYLES: Well, let us put it this way; as I said earlier, it has been dissappointing but,

not surprising. In other words, if we think in terms of the corporation itself, then really the corporation itself has not got too much to do with the development of the export business. It provides the re-discount facilities or, in other words, it facilitates the financing of such exports.

COMMISSIONER LEMAN: I understand that, but if there is any surprise in the lack of demand for it, I am wondering if we should look for an opportunity somewhere, either in E.C.I.C. ---

MR. BOYLES: It is surprising. We were hopeful of course that the volume of business being handled by the corporation would have been considerably more.

COMMISSIONER LEMAN: May I refer to your paragraph 135 which contains these words:

> "We recommend that the whole matter of existing limitations on the nature of the specific security available to the banks should be thoroughly reviewed with a view to leaving the banks as free as possible to take such security as the requirements of individual situations might indicate."

A little earlier in the paragraph you made reference to one impediment. You say:

> "For example, the power of the banks to take chattel mortgage security is at present limited to loans made to an individual on the security of household property (as defined in the Bank Act)...."

Is this just an example, or could you list a lot of other impediments that the banks have in mind in making these general remarks?

MR. WADSWORTH: You refer here to chattel mortgage security?

COMMISSIONER LEMAN: You seem to give that as one example of an impediment, and yet you say you recommend that the whole matter of existing limitations as to the nature of specific securities available be reviewed. I took the earlier sentence to mean that that is just one example. Can you list a lot of other examples?

MR. WADSWORTH: Another example would be the regular conventional mortgage security.

COMMISSIONER LEMAN: Would that about do it? Is that all? You suggest that it should be reviewed; we would be pleased to review it for you, if you would give us a few hints as to what to review.

MR. WADSWORTH: The principal recommendation would relate to mortgage security or security on immovable property, as we termed it a moment ago.

MR. BOYLES: I think the main point here, Mr. Leman, is that there should be no inhibition or restriction such as is imposed by the respective sections of the Bank Act. In other words, the question might arise, why should the bank be singled out for the restrictions that are imposed by that legislation? We see no reason why we should not be free of such restriction. I think that is what we had in mind.

COMMISSIONER LEMAN: I agree with you, in theory, that is true. However, we have heard before this Commission a lot of witnesses who criticized

for instance, the Industrial Development Bank and who said that sometimes the I.D.B. tied up a client to the extent that the bank took so much security in excess of its needs for a loan that the client was unable to provide credit for other purposes. Some have even suggested that at times the chartered banks, under the special security sections that are available to them, such as Section 88, have tied up customers and made other credit requirements difficult.

It is in that context that I suggest that the problem is perhaps not a theoretical one, that there are practical difficulties. What do you believe was the intention of the Act in prohibiting securities on immovables to be available to the bank?

MR. BOYLES: Well, I presume the theory was that a bank might very well find itself in the position, indirectly perhaps, of investing too much in a particular type of security.

MR. LORENZO HEBERT: The reason is a historical one. In the past century it was the practice of the American banks to lend on mortgages, and this is one of the reasons they had so many failures. In the first bank charter this was introduced to guard against that situation; otherwise we would have had the same trouble they have had in the United States and some other countries.

If I may add another thought, the situation since then has changed considerably. This is the reason why this prohibition is in the act now.

It dates from the very first charter of a Canadian bank, and it has been left in the other charters and in the Bank Act. But conditions, and the expertese of the bank in this field, and the risk involved are not what they were at that time.

COMMISSIONER LEMAN: Is it just possible that the legislators might have had in mind that the banks did not like to make long-term loans, and that security on first mortgages were particularly designed for long-term financing?

MR. LORENZO HEBERT: The main reason was the speculation on real estate at that time. The country was expanding, there was a frontier, people needed money, and there was considerable speculation. This was to avoid that speculation - that is the historical reason for it.

COMMISSIONER LEMAN: I will not argue with you as to whether that was the main reason or not, but let us examine the reason I have given.

I think the banks this morning explained to us that in general they are not too much in favour of very long term financing for business. Allowing them to take security on first mortgages on immovables of a business might enable the banks to tie up customers to a point where they had no credit left for financing the relatively short-term loans. Is that a possible difficulty?

MR. BOYLES: You might find a situation where a client is lacking in working capital but is

fairly long in fixed assets. Perhaps he would be creditworthy in respect of a loan, provided he could give security against his fixed assets even on a short-term basis.

COMMISSIONER LEMAN: Could there be perhaps a regulation to the effect that security could be taken on immovables for a loan shorter than X months?

MR. BOYLES: That is rather restrictive in operation.

MR. WADSWORTH: I think that would be unfair, Mr. Leman. May I add another thought on it.

To go back a bit -- we have covered this in our brief, and we know now from looking back there were many other extenuating circumstances in banking in the U.S. and other countries on mortgage security. But in the Canadian economy there has been a change in the regular conventional house mortgage field. Mortgages are now amortized to a large extent. They are more liquid to that extent, because as every month or every six months go by the equity becomes greater than it would with a heavy payment being made when the property is depreciated. I think that has made quite a difference in that type of mortgage security.

This morning, in speaking of mortgage security, I think we were talking almost entirely along the lines of that type of mortgage security. But there is the other area of the smaller borrower who, as Mr. Boyles said, may have need of working capital. I would extend that further to the borrower

who had capital needs and has no source of funds. It is in that area the banks feel they could play a useful role.

I think there has also been a change with growth at all levels of secondary industry in Canada; we have many more small businesses that are growing and expanding and which require term funds of a capital nature from time to time, and yet they are not of a size that they can go to the market or go through the procedure that has been followed where the banks can purchase a first mortgage bond, et cetera; the expense would not warrant it in most of the moderate sized loans.

You made the statement, I think, that we might find we were too far committed in this field. I believe that would be up to what I hope would be the good judgment of the bank concerned, and that they would not get over extended.

COMMISSIONER LEMAN: All I am trying to get at is, do you think that extending the right to take security on immovables by banks would tend to push them more into longer term, on average?

MR. WADSWORTH: I think on average it would, subject again to the availability of funds, and that being subject to whether the monetary authorities felt we were playing a useful role and that we should have funds for such purposes.

COMMISSIONER LEMAN: What about the reverse proposition: Would it be practical and useful to make all these sections, 82, 86 and 88, available

to any lender in Canada, not only to banks?

MR. NEAPOLE: That is a very difficult question to answer, Mr. Leman. Traditionally those sections have been in the Bank Act for a long time, and probably have been the most important sections of the Act in many different ways in development of business and the country generally.

I think one of the difficulties about making security of that kind available to all lenders would be the problem in people ascertaining the security and so forth. As it is now, they are registered securities. I think if they were available to all kinds of lending organizations, such as credit unions and bodies of that type, there would be extreme difficulty in confining the operation to something about which people would have knowledge.

COMMISSIONER LEMAN: They would have to register too, wouldn't they?

MR. NEAPOLE: I would assume they would, yes.

MR. PATON: Mr. Leman, may I point out that sections 88 and 82 are general rather than specific. Under Section 88 it would not be possible to have two lenders hold security on the same location. The location has to be specifically described. All of these refer to where the inventory or the goods lie. It would be very difficult, if not impossible, to have lenders with different interests in the same security.

Section 86 is different, because that

is specifically a warehouse receipt against an item in the warehouse. Section 88 is more general.

COMMISSIONER LEMAN: Perhaps there would be difficulty in making the same security available to two different lenders. But if a lender had a client that was not a bank's client, I am wondering what difficulty there would be in extending this particular variable type of security to such lender. Do you feel it is something that could be abused by lenders?

MR. NEAPOLE: Being one of the lenders, I would hesitate to say that, but I would say it could be. It always could be so, but I would not advance that as a strict objection.

I think one of the principal things about the banks being able to do this is that they themselves as a rule require reporting, inspecting and policing of the security, and I like to think it would be done more effectively by banks than by other lenders. I am using the word in a very broad sense now.

COMMISSIONER BROWN: The banks are asking to have other security open to them; why shouldn't the security they have be open to other people?

MR. NEAPOLE: Well, it is a good question. Why not? We have been talking about sections 86, 88 and 82.

COMMISSIONER BROWN: Those are the ones we are talking about.

MR. NEAPOLE: In a categorical sense, why

not? I would not object, so to speak.

COMMISSIONER BROWN: Section 88 is unique to Canadian banks. What do banks in other countries do -- they seem to operate successfully?

MR. NEAPOLE: They have other means of taking security.

COMMISSIONER BROWN: What do they take?

MR. NEAPOLE: Assignment of receivables, and in some cases something similar to a registered charge, like a debenture. I say "similar to" because I am not entirely familiar with the situation.

COMMISSIONER BROWN: If banks were given mortgage facilities, we could wipe out section 88? I am just flying a kite now.

MR. NEAPOLE: In what sense, wipe out Section 88?

COMMISSIONER BROWN: We would do away with Section 88. Could you not operate then as banks in other countries operate?

MR. NEAPOLE: It would be extremely difficult, because I don't know of any other vehicle here for the assignment of receivables.

COMMISSIONER BROWN: In the United States, Britain and France they seem to operate successfully without a Section 88 or something similar to it. I bring this question up because criticisms have been made that banks tend to take more security than other people feel is warranted under Section 88 and as a result other suppliers who have delivered goods which have not been paid for find that those

goods are seized by the bank.

MR. NEAPOLE: That has happened, yes. That claim is particularly made in the canneries, where there are seasonable enterprises, fisheries, vegetables and so forth. But by the time the product has been canned the bank, by making loans, has in effect substituted itself for other preferred creditors. The loans have gone out to pay wages; at least all the wages would have to be paid, and on top of that there are certain distributions made to the growers from time to time, and also certain payments made to the suppliers of cans, and so forth.

As a rule, suppliers of cans, labels, cartons and so forth are familiar with the affairs of the canner, and he is familiar with the bank. The bank explains the situation, and they work it out between them, with the canner right there on the spot.

I would say that the advantages of the Section 88 procedure have far outweighed any disadvantages. It is perfectly true that creditors have been caught from time to time, whether with canners, or textile convertors, or other enterprises; the fact remains that they are taking a business risk the same as anybody else is.

MR. WADSWORTH: May I add a further comment on your remark, Mr. Brown? I would look upon it as Section 88 supplementing the security you mention. I think there are many borrowers who give a general assignment on receivables, and under Section 88 security they are still borrowing on long-

term, under a mortgage on their plant. With a first mortgage bond there is probably some clause there permitting them to get security under Section 88 on their inventories. So, I think it is a combination of the three. The fact that we could take mortgage security might assist to a degree, but there might be cases where we would take Section 88 security and not mortgage security. The mortgage financing may have been arranged elsewhere, or some other lender might have been more competitive in that area.

MR. BOND: I suggest that if we take mortgage security out of the Bank Act we would have to put it in some other act, and if you did that you would very likely deprive the people of the province of Quebec of any security at all, because in Quebec you cannot take a pledge of chattels. So, I say if you took Section 88 out of the Bank Act you would have to put it in some other act.

COMMISSIONER BROWN: You said if you took "mortgage security" out.

MR. BOND: I meant that particular form of mortgage. It would raise a constitutional point in Quebec. In that province you might deprive them of any security of that type, including the banks.

COMMISSIONER BROWN: I am curious to know why our banking system couldn't function in the same way as banks function in other countries.

MR. PATON: I think the answer may be that business over there probably gets more sub-

stantial lines of credit - that is businesses that borrow under this section. If we eliminated Section 88 the bank credit could not remain at its present figure, unless the bank could take private security.

COMMISSIONER BROWN: This brings up Mr. Leman's point, but if we give the banks more and more facilities to take up more securities, we are going to have all the credit in the country concentrated in one place. Therefore I throw out my first suggestion that if you extend mortgage lending to banks I think you must consider extending some of these other facilities to competing lenders.

Before I leave this, there is one point that has not been brought up, and I am surprised that you did not mention it in your brief; that is, as to widening the security under Section 82, to include other than straight hydrocarbons.

MR. NEAPOLE: It never came up in our discussions in 1954.

COMMISSIONER BROWN: Are you quite happy just to have hydrocarbons?

MR. NEAPOLE: What else do you suggest?

COMMISSIONER BROWN: There are some other by-products that exist and which are measureable.

MR. NEAPOLE: I think they might very well be covered in the description now - gas, and so on.

COMMISSIONER BROWN: How about minerals, sulphur, and so on?

MR. NEAPOLE: The products of the mine

and so forth are included in the act now under Section 88.

COMMISSIONER BROWN: I am talking about Section 82.

COMMISSIONER LEMAN: It covers products of the mine once they are on the surface, but not underground.

MR. NEAPOLE: Correct - or detached, so to speak.

COMMISSIONER BROWN: However, we have been talking about the bank having too much security; now that you are quite happy with Section 82, perhaps we should drop that discussion.

MR. WADSWORTH: I think, broadly speaking, it would be desirable if the banks had broader powers.

To go back to the question of Section 88, the banks at this time have not said that any form of security they want should be withheld from any other type of lender. We are asking for freedom for ourselves and we must expect it for others. But under Section 82, it would be hard to assess the extent to which this is being used now. You mention minerals. As you know, in the oil and gas industry, the experience of the highly technical skills that people have today means that they can estimate fairly accurately the reserves and recoverable portion of those reserves. The estimating of recoverable reserves from a gold mine that has not yet been fairly blocked out, has not advanced quite to that point. I think if the bank had the freedom

to take such security , as and when the technical changes and new developments take place, it would be most desirable, because the role the banks have played since we have been able to take Section 82 security in the oil and gas business, has been a relatively significant one.

THE CHAIRMAN: We will adjourn for ten minutes.

--- Short recess.

THE CHAIRMAN: We shall now resume.

COMMISSIONER LEMAN: Before we leave the subject of security can you tell us if the banks now have worked out a certain rule on the ratio of security to support a loan? Are there any rules about the ratios that you work to?

MR. MULHOLLAND: Under section 88, Mr. Leman?

COMMISSIONER LEMAN: Yes; let us say under section 88.

MR. NEAPOLE: Let us take section 82 first, if I might, Mr. Leman. There you have the cut and dried operation but where there is a very, very highly prepared appraisal of the oil in the ground or the gas, as the case may be, or both, and there is also a present, so to speak, market value ascribed to it, we work on the basis of 50 per cent of this prescribed value, provided that the flow from the well, whatever it is -- the production -- is of course sold and is going to produce a pay-out in from four to five years. That is a fairly, shall I say, definite type of operation under section 82.

COMMISSIONER LEMAN: Are you speaking now for all the banks or for just the Royal Bank of Canada?

MR. NEAPOLE: I can only speak at this particular moment for ourselves, but I think they are all more or less the same. They would not be very greatly different. Now, insofar as section 88 is concerned, you have such a vast variety of products and the man's own equity enters into it so much, that I could not say there is any hard and fast formula.

I am reasonably certain, for instance, that if there was an assingment under section 88 dealing with ingots of aluminum or metal that had a definite market and was in quantities that could be marketed, etcetera, that you would find people making some kind of judgment as to how much they could lend against that particular commodity. However, I cannot give you any hard or fast rule on section 88 generally.

COMMISSIONER LEMAN: In that case you would feel it would have to be an ad hoc judgment on each loan?

MR. NEAPOLE: Yes, based on the fact, as I said, that the man's own equity is going to enter into it very much, and the product too, of course. As you can understand if you have a project which is partially manufactured it might be almost useless in any other business, let us say, there being no particular realizable value except to run it through the plant and finish the operation, which might not be feasible.

MR. MULHOLLAND: It may be a fair statement to say, Mr. Leman, that when the section 88 security finds itself converted into receivables there might be more of a margin that could be stated, and that margin of a bank loan against good receivables might be something between 15 per cent and 25 per cent. I am just stating my own opinion in that respect and I am not speaking on behalf of the Association.

MR. NEAPOLE: That is the margin.

MR. WADSWORTH: I do not see how the security referred to could be broadly affected if it were subject

to stipulations for certain limits. The case Mr. Neapole mentioned under section 82 broadly applies to all of us, but I am sure the ratios differ a bit between various types of lending institutions, not only banks but others, as to the amount they would lend against oil in the ground. Some consider the gravity in relation to put-out, and so on. So, I do not see how you could work out any precise formula that would apply.

COMMISSIONER LEMAN: No; I was just wondering if it might be possible to put some minimum ratios on, especially if there were to be complete freedom as to what security banks could take.

MR. WADSWORTH: I do not think so. I think in the case of mortgage security in a business enterprise, even if we had the permission to take mortgage security, we would not be the only lender, and if it were felt that better terms might be obtained elsewhere and by borrowing under mortgage security from some other source, I think the borrower would do so.

MR. BOYLES: The governing factors here, Mr. Leman, are basically the financial position of the borrower and the type of business in which he is engaged. Those are really the determining factors.

COMMISSIONER LEMAN: Well, we have gone down the spectrum of the classes of assets except for one section and that is the one where we had bunched provincial, municipal, and corporate securities. I took from your submission, and I hope I interpreted it correctly, that there has been rather a reduction in the

proportions of holdings of banks of these three types of securities in the last, say/ in post-war period; is that correct?

MR. HACKETT: Well, Mr. Leman, I think that is broadly so. Since we are talking about proportions I think that that trend is perhaps the obverse, the other side, of the relative increase in loans as a percentage of total assets.

COMMISSIONER LEMAN: They have not reduced in the absolute, in other words?

MR. HACKETT: That is true, sir.

COMMISSIONER LEMAN: Although you do give some explanation of that in paragraph 86 and following of your submission, I am not too clear on why they have lost in popularity as holdings for banks' portfolios.

MR. HACKETT: Well, sir, I do not think they have lost anything by way of popularity. Perhaps I had better divide my answer somewhat to deal with the different types of securities. Perhaps it might be more helpful if I were to do that. I will, perhaps, take corporate securities first. I think it was about the mid-fifties that we had a combination of circumstances in this country which involved a very high level of new corporate financing, new capital spending, reflecting increases to plant capacity, and at the same time, relatively easy money conditions.

There grew up to be almost a pattern of public corporate financing at that time of including as part of the issue short-term serial bonds that ran from one to five years, sometimes as long as one to ten

years.

From the standpoint of the borrower that was a way of reducing the overall cost of the financing. From the standpoint of the banks it was a relatively attractive combination of maturity and yield, having regard to the level of yields prevailing at the time, although one is bound to confess one sometimes shudders when one looks at these yields now.

Since that time I think it is accepted that the volume of new corporate financing requiring public financing has tended to diminish. One of the reasons for this, I think, has been an increase in tendency on the part of corporations to finance more out of retained earnings. I think that has something to do with the nature of the capital expenditure that has been going on in recent years. At the same time these securities, having been originally issued in serial form, have started to run off and the opportunity for replacement, due to the nature of the demand and also due to general monetary conditions -- you do not have as much room as you did for that kind of thing -- has not kept pace with the pay-offs. So much for corporate securities.

As to municipal securities, and I think the same thing holds true in all these three areas, there has been great competition in the case of loans. But even in the case of municipal securites there have been one or two special factors which, in recent years, have somewhat tended to reduce the availability of these securities to the banks.

One is the fact that in certain areas and

in certain combinations of areas there has been a greater tendency on the part of the municipality to do financing in New York.

A second factor has been a certain tendency for Municipals to be issued in straight-term, longer term form instead of in the short-term serials. That, I think, is a market preference. The market, at times, has shown a decided preference for that type of issue to the type of issue which in normal times would find its way into the portfolio of a bank.

A third factor which is of some significance has been the tendency in certain provinces for municipal financing to be done under the aegis of provincial borrowing authorities. I am referring to such operations as the Alberta Municipal Financing Corporation, where the securities come to the market as provincial rather than municipal obligations.

I think it is this combination of considerations that explains why these non-federal government securities are not a relatively greater proportion of total bank assets than they are but rather a somewhat lower proportion.

COMMISSIONER LEMAN: It is not a reflection of any disillusionment on the part of the banks, is it?

MR. HACKETT: None whatsoever, sir. It is a case of partly a different set of conditions and partly a greater relative demand in other directions, particularly lending.

COMMISSIONER LEMAN: To come back to the

corporates for a second, is there any relationship between the development relative to corporate securities and the concept that you explained this morning about the views of the banks regarding term loans, for buying a corporate security is somewhat akin to lending long term, is it not?

MR. HACKETT: Yes, sir. I think it is. I believe that one's policy views with respect to the acquisition of a corporate security cannot be disassociated from what you are doing or what you have to do or the fact that you are under certain limitations with respect to the making of term loans because, as you say, sir, conceptually there is very little difference.

COMMISSIONER LEMAN: Is this basically something the banks have developed out of their own volition or under some pressure by the monetary authority or what?

MR. HACKETT: Well, at times when we have been under restriction with respect to the making of term loans, or under limitation, this limitation applies equally to corporate securities purchased directly from the issuer. As you readily appreciate, there is not much sense in not being able to make a term loan if you say to the person, "Walk out of here and bring me your bond issue instead and I will buy it". There logically has to be a consistency there.

COMMISSIONER LEMAN: In this area you comment also on the banks' activities in paragraph 234 and following, and that is the function of the banks as

underwriters. First of all, I should like to ask you a general question to start with. Is this a function that the banks like? Would they like to be heavily involved in underwriting?

MR. AVISON: May I answer that, Mr. Chairman? This is in part, Mr. Leman, historical. Banks have tended to be associated with syndicates in the underwriting of securities, and this pattern has continued over the years. I think it is fair to say that the banks like it.

COMMISSIONER LEMAN: You say basically the banks like it?

MR. AVISON: Yes, sir.

COMMISSIONER LEMAN: Would you, like Mr. Hackett, make any distinction between the provincials, municipals and corporate securities, or would you not make any distinction?

MR. AVISON: In connection with underwriting?

COMMISSIONER LEMAN: Yes.

MR. AVISON: Well, let us do what Mr. Hackett did and take the corporate issues first. I think that with very few exceptions -- you could probably count them on one hand -- banks do not participate in syndicates with respect to the underwriting of corporate securities.

In the municipal field, of course, the banks for the most part participate, not entirely but for the most part, in syndicates underwriting municipal issues. These syndicates might be very small or they might be very large. Some syndicates may only have one bank in them, and some syndicates may have two or more banks in them.

In the provincial field, as you know, the fiscal agency technique is usually employed, but not entirely, where the syndicate combines to form a fiscal agency, and it will be found that most of the banks are in that agency.

COMMISSIONER LEMAN: Well, so far as the corporates are concerned, what are the objections? You say the banks are just not underwriters of corporate securities.

MR. AVISON: With very few exceptions, that is true.

COMMISSIONER LEMAN: What are the factors that account for this? If you basically like the underwriting function, why would you not like the underwriters' function with regard to corporate securities?

MR. AVISON: I suppose the simple reason, Mr. Leman, would be that we have not been invited into the syndicate, whereas we are invited into the municipal and provincial syndicates. The banks cannot sort of initiate themselves into the syndicate.

COMMISSIONER LEMAN: You have given us general comments here in this chapter of your submission about the underwriting function of the banks. Could we get some numbers on the amount of underwriting that has been done for various types of securities, where it has been done?

MR. AVISON: I do not beleive these figures are available in total. Each individual bank would have them.

COMMISSIONER LEMAN: Why would this be an

area where the Association would not have figures? I am just asking. There may be a good answer.

MR. AVISON: I just do not know.

COMMISSIONER LEMAN: Is this a field where the Association would be prepared to gather some figures for us?

MR. MULHOLLAND: Yes, Mr. Leman.

MR. HACKETT: If I might make an observation there, Mr. Mulholland, I suppose it is clear that in any underwriting syndicate a bank may only have a relatively minor percentage interest in that syndicate. There may be one or two banks, there may be ten or a dozen dealers, if the syndicate be a large one.

COMMISSIONER LEMAN: Well, I suppose you could get some figures which would give us a good indication of the volume of underwriting by banks.

MR. AVISON: May I ask a question? What you are looking for is a total figure for the Association of the amount that all banks have shared in all syndicates in which they have participated in issues of both municipal and provincial securities?

COMMISSIONER LEMAN: Yes. I do not think we would need this bank by bank.

MR. AVISON: That would be a difficult figure to dig out with any speed, Mr. Leman.

COMMISSIONER LEMAN: What do you call speed? I am just suggesting that at some future date you could file this through the secretariat of the Commission.

MR. AVISON: I am satisfied the figure could be obtained.

MR. WADSWORTH: Would this relate to the percentage of banking participation in the syndicates, the syndicates that they were connected with?

COMMISSIONER LEMAN: No, the shares that the banks themselves handle.

MR. WADSWORTH: May I just ask a question because -- and I think I speak for all of us -- we would like to provide any information that it is possible to provide. Is it a question of the share of, say, the syndicate liability which the bank may have taken in a syndicate or the share of that issue that the bank may have assisted in placing?

COMMISSION LEMAN: When you are in an underwriting syndicate you perform, I suppose, both underwriting and distribution?

MR. WADSWORTH: Well, we could provide both, but in some cases we would not provide both; in some cases we would only have a syndicate liability for any unsold securities, the main amount of the selling may have been done by other members of the syndicate, so it is just a question of pin-pointing what you would like from us.

COMMISSIONER LEMAN: As I say, I would like to see some figures -- I don't know exactly what you can supply -- but I am asking you if you could give us figures that would give us a good notion of the volume that is handled by banks in the underwriting function and in the distribution of it?

COMMISSIONER BROWN: Could I make a suggestion to see if this would fit in with your ideas on what might be feasible; the dollar value of syndicates in which the banks have participated, and the dollar value of the liability taken by the banks.

MR. AVISON: May I repeat that to see that I understand it? The total amount of new issues in which the banks participate in the syndicate as members, and the proportion which the banks assume of the liability in that syndicate of that total figure?

COMMISSIONER BROWN: That is right.

MR. AVISON: Do you want this for a period of years or for, say, a typical year; for the year 1947 and the year 1962, or something?

COMMISSIONER BROWN: Mr. Leman is asking the question.

COMMISSIONER LEMAN: Well, if it were possible to have it for a period to see if the volume has been increasing; I don't know, a period of seven or eight years, would that be possible?

THE CHAIRMAN: I suggest that you arrange exactly what you want afterwards, perhaps, and work something out?

COMMISSIONER LEMAN: Yes.

THE CHAIRMAN: Which would be satisfactory.

MR. WADSWORTH: Before we leave that point, may I add one further comment in connection with this in relation to corporate securities. I think a contributing factor is the distribution of securities by banks, etcetera. A great deal of our distribution

is in the form of almost order-takers through our wide branch system, particularly in municipal issues and things such as that. Apart from Government of Canada bonds -- I think we mentioned this in our brief -- the banks do not recommend any other type of security, but we will execute orders from those interested, and I think the degree of interests from the average bank customer who comes to the bank is much more in provincial and municipal issues than it is in corporate issues, and I think that has some bearing on why we do not appear more often than we do in corporate syndicates.

COMMISSIONER LEMAN: And in the corporate, as Mr. Hackett pointed out earlier, there are seldom any shorts in the issue?

MR. WADSWORTH: That is right.

COMMISSIONER LEMAN: Whereas in the municipal issue there would be shorts?

MR. WADSWORTH: We are not as much a direct participant, either.

MR. HACKETT: I think there is another factor, too, in that the history of corporate underwriting in Canada usually involves a long standing and continuing relationship between the borrower and the issuing house. Corporate issues are not sold by tender; it is an arrangement, a continuing connection, and that is the pattern that has grown up.

COMMISSIONER LEMAN: Could you describe to us the general way in which this business has developed; how did banks get into syndicates? Are they usually permanent members of a syndicate, for this

fiscal agency that is of long standing, or is it an ad hoc decision in each case to get into the syndicate?

MR. HACKETT: No sir, syndicate arrangements are usually of very long standing; they go back for many years.

COMMISSIONER LEMAN: And do these tend to be arranged along the lines of a group of dealers in the bank to handle securities, or are there sometimes more than one bank in any one syndicate?

MR. HACKETT: If it is a large syndicate there is more likely than not to be more than one bank; sometimes there can be five or six banks in a very large group.

COMMISSIONER BROWN: I would like to ask if the banks have a view on the question of Section 157, subsection 2, in view of their liking for participation in syndicates?

MR. HACKETT: Yes, I think we do have a pretty well defined view on that, sir, and I think our view arises from our interpretion and the purport of this section, which we think is useful.

COMMISSIONER BROWN: Perhaps you would read the section for the record?

MR. HACKETT: Pardon?

COMMISSIONER BROWN: Have you got it there, or will I read it?

MR. HACKETT: Yes, it is section 157. I don't know if you wish me to read it, sir, but this is the section which prohibits the use of the name of a bank in any prospectus or advertising for securities.

If you wish me to read the section in total, I will.

COMMISSIONER BROWN: I have it in front of me.

MR. HACKETT: Right. Well, I think our view is that this section is useful in that it removes the possibility that any investor -- possibly a somewhat unsophisticated investor -- might buy a security under the impression that the bank's name on the prospectus was advertising, or to imply that the bank was in some way directly or indirectly responsible for the fulfillment of the borrower's obligation.

Section 157 approaches that, of course, very directly by prohibiting the use of the bank's name on there in any context whatever; we think it is a possibility that human nature being what it is that this would happen if the bank's name were on the advertising for the sale of securities. I should have added that advertising for the sale of Government of Canada direct or guaranteed securities is exempt from this prohibition.

COMMISSIONER BROWN: You think it is safe to advertise them?

MR. HACKETT: I think so, but I think the point is that if the bank name were on there, some sort of responsibility for the fulfillment of the obligation will be imputed to the bank no matter to what lengths the bank might go to endeavour to remove such an impression, and for these reasons I think we feel that the section serves a useful purpose.

COMMISSIONER BROWN: Is there unanimity of

view on this?

COMMISSIONER LEMAN: Does that mean that they definitely would exclude banks from underwriting corporate issues?

MR. HACKETT: It wouldn't exclude, sir, a bank from participating in underwriting, but it would exclude the appearance of the bank's name on the prospectus offering the securities ~~to~~ the public.

COMMISSIONER LEMAN: Well then, I haven't got the details of the various securities acts so much in mind that I would be able to solve this right here, but does that entail, therefore, a change in the securities laws, because normally it is required that the underwriter's name be disclosed in the prospectus, isn't it?

MR. AVISON: I think that is true of corporate debentures, yes.

MR. HACKETT: But you still couldn't put the advertising in the paper with the bank's name, in the actual offerings of these securities to the public.

COMMISSIONER LEMAN: That is why I am suggesting that unless these securities acts themselves were to be changed, banks couldn't underwrite corporate issues because the securities acts require that the underwriter's name appear in the prospectus.

MR. HACKETT: That is a legal point --

MR. AVISON: I think that is quite right.

COMMISSIONER LEMAN: Well, we have heard from quite a number of witnesses a lot of suggestions about the securities regulations in the country, the

limited participation of the banks in the underwriting and distribution of securities; does this enable you to give us the benefit of your comments on the adequacy of these regulations?

MR. HACKETT: I beg your pardon?

COMMISSIONER LEMAN: Either the bankers or the general observers of banks.

MR. HACKETT: I think it is fair to say, Mr. Leman, that through the years these regulations have become more adequate, and secondly that there is an increasing degree of coordination between the various provincial agencies in this area.

COMMISSIONER LEMAN: To the point where they satisfy you?

MR. HACKETT: I think, like everything else, this is an evolving thing; I think from time to time situations do arise, but one of the situations, of course, is that of the operator who doesn't do business in this country but may take up residence here and do business outside Canada; that is the situation which is being dealt with, and I wouldn't say that the problem has been wholly solved yet, but I think it is something which the various Commissions are extremely conscious of.

COMMISSIONER LEMAN: Well, we have all heard a lot of representations about the full disclosure requirements of special corporations in their annual reports and in their perspectus. From the point of view of banks as investors and lenders, do you have some comments to make on this, the adequacy of the disclosure

requirements as they exist today?

MR. HACKETT: No sir, I think the general trend of practice and procedures in this area over a good many years have been in the direction of giving the investor the fullest possible information he can get, and I don't at the moment have in mind any specific area in which I would suggest improvements might be arranged. That is not to say, perhaps, we couldn't think of some, but I think the investor in this country gets a good break in the way of disclosure of information.

COMMISSION LEMAN: If I might turn to another subject, unless you have something on that, Mr. Brown?

Sometime ago there was an announcement regarding the possible development of a bankers' acceptance market in Canada. Until now has any progress been made in this field, or can you report none?

MR. AVISON: I think it might be fair to report, Mr. Leman, that through no fault of the banks the timing of the introduction of this new market almost coincided with the most recent period of high rates and relatively heavy demands for loans, with the result that about eight months, perhaps, seven months, in our view could hardly be construed as a typical period in which to properly determine whether this market will develop or not.

COMMISSIONER LEMAN: What is it designed to finance?

MR. AVISON: These items which -- I haven't got the Bank of Canada Act in front of me, but it is

these items which properly fall under 18(1) item G of the Bank of Canada Act.

COMMISSIONER LEMAN: Could you describe generally what these are and what this covers?

MR. AVISON: If I may read the section. You will notice that in the powers of the Bank of Canada Act they are empowered to buy and sell, and so forth, and we are using items F and G purely as illustrative of the areas in which bankers' acceptances can be drawn. It deals with the production and marketing of goods, wares and merchandise and in connection with the production or marketing of products of agriculture, products of the forest, and quarrying, mining, and products of the sea, lakes and rivers; and these are the typical areas to which bankers' acceptances were to apply.

COMMISSIONER LEMAN: Well, such a market is fairly active, say, in New York, isn't it?

MR. AVISON: It varies. It recently has been quite active.

COMMISSIONER LEMAN: Are there peculiarities about our environment here in Canada that make it more difficult for such a tool to become developed?

MR. AVISON: I think, sir, it might be said that we have developed other tools, that are normally letters of credit in connection with exporting, for instance; it has long been used by the banks.

Secondly, with straight credit made available made in the normal course of business, and to some extent in both these areas, bankers' acceptances

perhaps duplicate the facilities that were existing.

I think it would be an improper answer to your question if I did not include also the development since the money market developed in 1954, and this development has taken place much more recently than that of a fairly active straight market in commercial trade.

MR. NEAPOLE: May I interject there? I think that it is safe to say that these were introduced at a poor time in so far as rates are concerned. The rates for bankers' acceptances was 1¼ per cent, which added to the rates which the borrower would have to pay on the market. It would be more than he could normally borrow for, and consequently, the average person who might have used these bills would have found them too expensive and consequently back away from them.

A few million dollars, probably, amongst the banks have been sold, but up to now it has not been successful, and when I say "successful" I mean it in the sense that it might have been. Another limiting factor is that we have a limit on the bills of a minimum of $200,000. We are now going to try it with the limit at $100,000 and see what happens, but it is a question of trying to reach a maturity in developing a market of this kind. We have not reached it yet.

COMMISSIONER LEMAN: In your estimation what sort of companies would use these and find them appropriate?

MR. NEAPOLE: Manufacturers and dealers in commodities, and so forth, would possibly be able to use them with their name along with the bank's acceptance, and sell their paper through a dealer just as other people do, except as Mr. Avison pointed out it would apply to the people mentioned in Section 18 (f) and (g) of the Bank of Canada Act. In other words, there would be commercial transactions underlying the paper.

COMMISSIONER LEMAN: We have had a couple of witnesses who have remarked to us that perhaps in the short-term commercial paper market great care should be exercised to make sure that the borrowers are absolutely creditworthy in all cases, and that perhaps they had not been creditworthy. The development of an acceptance type of short-term borrowing of that sort would help in that

direction, would it not?

MR. NEAPOLE: Yes, it would, because with the bank's acceptance on the paper then, of course, you have a bank instrument for the debt.

COMMISSIONER LEMAN: And the bank would make sure that the creditors are good?

MR. NEAPOLE: They would have a good look at it because they would have to pick up the paper when it matured.

COMMISSIONER BROWN: Do you think that perhaps the banks were a little slow in developing this? In other words, has one of the inhibiting factors been the development of a market for unaccepted business?

MR. NEAPOLE: I would not say entirely. As a matter of fact, as I mentioned once before, this whole question is one of trying to develop a market for a certain type of instrument which we feel -- well, if you come of age, so to speak, in a financial market, you ought to have an instrument of this kind available for people. However, I will be perfectly frank and say that even the bankers squabbled about it among themselves for months and months, and could not reach an agreement as to the method of operation, and so forth. However, it was born finally, and it has not reached any maturity yet, as I have said.

COMMISSIONER LEMAN: Before we leave the general question of bank assets, can you give us a brief run-down as to any trends that are noticeable,

let us say, in the postwar period in the lending policies or the natural development of the banks' loans. Has there been a shift towards more numerous smaller loans, or less numerous larger loans? Has there been a definite trend or direction?

MR. NEAPOLE: Well, speaking without any information right at my elbow here, I would certainly say that there has been a trend to many more smaller loans. There have been many more smaller loans. There is no doubt about that, and they have been caused particularly by the government guaranteed segment. I do not think I can say there has been a trend percentagewise towards more large loans than before. I think there is still pretty much the same spread right across.

Quite obviously, the mortgage business has entered into it as well, and that has resulted in a change in assets. There has been consumer lending, of course. But, by and large, I think you could answer the question by saying that there are many, many more small borrowers who are being taken care of in one way or another.

COMMISSIONER LEMAN: Well, do you think this trend towards more numerous smaller loans has reached a peak, or is it likely to continue, or what?

MR. NEAPOLE: Whether it will continue percentagewise is very difficult to say. I think it will certainly increase numerically. In the loan business, such as consumer loans, there is a tendency to reach a sort of plateau. You can

develop beyond that plateau by forcing your advertising or you might drop a little bit below that plateau by toning your advertising down.

We have certainly found in our own experience -- and I am sure the others have found this out also -- that with a little pressure placed on advertising there were more applications for consumer financing. I do believe, nevertheless, that there is a certain natural level, so to speak, that you reach, and that within certain limits beyond that it will sort of wave along a line although, numerically, it might still increase.

COMMISSIONER LEMAN: That concludes the questions I have to ask on this topic.

COMMISSIONER BROWN: Mr. Chairman, I would like to switch over to the other side of the balance sheet and look at deposits for a while. It might be a good thing to start by looking at paragraph 189 of your submission in which you say:

"In deciding how and where to hold his savings, an individual will normally be governed by the following five considerations:

1. The safety of his funds;
2. The readiness with which his savings can be converted back into cash;
3. The rate of interest or other return received;
4. The ease and convenience of making the necessary transactions;

" 5. Other services offered in conjunction with the savings facilities."

I would like to get your opinion here. Are these in order of precedence, or what do you think would be the more important factor that influences this?

MR. PATON: If I might respond to that question I would say that this is a part of the wording of the brief that we would change slightly if we had to rewrite it.

COMMISSIONER BROWN: You can rewrite it now if you want to change it slightly.

MR. PATON: There was no intention at the time the brief was written to indicate an order of priority in respect to these five factors. We are inclined to feel that all five of them are important, but their order of priority in one situation would be entirely different from their order of priority in another situation, depending upon the depositor.

I do not think there is any doubt that the main priority, and one that everybody has, is that of making sure that the money can be recovered. Safety of the funds is important, but with the continued strength of the banking system that has become axiomatic.

If one were to conduct a poll and ask our depositors to place these factors in an order of priority it might be found that to many depositors depending upon age, convenience of location is important. To another depositor the variety of

services offered would be valuable and important. To another the rate of interest would be important. The return would be more important in some instances than in others. All those factors mentioned there are important, but they are not necessarily in order of their degree of importance.

COMMISSIONER BROWN: How important do you visualize the rate of interest to be? Let me add into that question this: Can you give an opinion as to the point at which it starts to become important? On a hundred dollar account the difference between 2 3/4 per cent and 3 per cent is 25 cents a year. At what size does interest become important, or is it a psychological factor?

MR. PATON: I would say in answer to that that deposits of all sizes are sensitive to rate adjustments. What is important to one individual might not be important to another.

As you are probably aware from the public information and returns, a large percentage of the banks' savings accounts are for comparatively small amounts. To quote statistics I think that 55 per cent of the savings accounts have balances of under $100. These funds would normally represent the savings of the individuals concerned. Perhaps they are a reserve for some emergency. Perhaps they are accumulated to provide funds for some expenditure. What is important to one individual might be $100 and yet the account might not have any importance to another individual until it has reached a balance of

$1,000. It is difficult to relate the importance of the interest rate to any specific amount. It depends in all circumstances upon the owner of the funds. However, there is more sensitivity as the amount involved increases.

COMMISSIONER BROWN: This comes up later in regard to the matter of competition between the banks and other financial intermediaries, but I would just like to get an expression of opinion as to how important it is relative to some of these leading financial institutions, particularly when you bear in mind that, apparently, on the paying side consumers are relatively unimpressed by differences in interest rates. They do not seem to care whether they are paying 20 per cent or 25 per cent. Having regard to that fact it seems strange that on the other side a small margin can make a difference. Do you really think that this factor influences the paying in of funds as between the banks and the near banks?

MR. PATON: I think it is very important, sir. I think the tables at pages 187 and 188 of the brief indicate that there is an importance, and that competing institutions are rapidly gaining in percentage ownership of these obligations.

COMMISSIONER BROWN: Your opinion is that the interest rate as such has played an important part in this growth.

MR. PATON: I think the deposits in the chartered banks were $14 billion in 1961, and those in

competing institutions amounted to $5.357 billion, but percentagewise the increase in the deposits in the chartered banks has not been closely related to the increase in the deposits in the near banks, as we refer to them.

COMMISSIONER BROWN: How important do you regard the factor of convenience of location of branches, and so forth?

MR. PATON: I think it is difficult to put a dollar valuation on the importance of that. We feel that it is very important.

COMMISSIONER BROWN: Are branches opened in order to attract savings, or in order to put out loans?

MR. PATON: That is one of the fundamental purposes of opening branches. Some are opened with the weighting over on the one side rather than the other, but fundamentally branches are opened for the purpose of, firstly, attracting deposits, and, secondly, making loans.

COMMISSIONER BROWN: In other words, you think that this is a pretty important factor?

MR. PATON: I do not know what other general managers have to say about it, but I think it is difficult to place a dollar value, or a percentage, upon the importance of it.

COMMISSIONER BROWN: What I am getting around to is if the ceiling were lifted on what you could charge you would, therefore, be in a better position to pay more, and if you add this factor

to the branches that you have covering the country, is anybody going to be able to compete with you?

MR. PATON: We have no fear that we would overwhelm the others in this respect. We feel that there is a place for the other specialized institutions, and will always continue to be.

COMMISSIONER LEMAN: Any concept that you would have with respect to that would not be one of fear, would it?

COMMISSIONER BROWN: Have any of the other general managers anything to add to this discussion?

MR. NEAPOLE: I would say that we have certainly opened branches with the object of obtaining deposits. Once in a while there will be an important client near a location who will ask to have a branch opened there, or something of that nature.

I think the interest factor makes a big difference. It is a strange thing to consider how people will not quibble about the interest they have to pay when they borrow to buy a washing machine, or some such thing. In other words, the interest they have to pay for the borrowing in that case might not bother them at all, but if they see a sign in a window offering 4 per cent or more then I am sure, when they relate that to our 3 per cent, they make the first turn in, in many, many cases.

It would be most difficult to try to categorize these five different items here and actually

give a breakdown of them in order of importance, because unquestionably location and a few other things do enter into it. However, by and large, I am satisfied that that figure of 4 per cent or more is a big factor. There is no question about it in my mind, Mr. Brown. It is a big factor.

COMMISSIONER BROWN: At the moment you are running three general types of personal deposit accounts.

MR. NEAPOLE: That is right.

COMMISSIONER BROWN: You have the demand account, the personal chequing account and the savings account.

MR. NEAPOLE: Yes.

COMMISSIONER BROWN: Has the development of the personal chequing account been up to expectations?

MR. NEAPOLE: Well, in so far as our own bank is concerned, we feel it has not done too badly at all. I think that probably we have a higher percentage than some of the others and that is because, perhaps, we have pushed it more. The personal chequing account by itself is not meant to be a deposit gathering account. We had hoped ultimately that the development of the personal chequing account would mean that the savings accounts would become more pure savings accounts with less chequing and so forth, as they are almost anywhere else. I think it is safe to say that Canada is the greatest cheque-writing country in the world, and , of course, cheques are written against savings accounts as well. There

is a very, very heavy volume which is, of course, a costly operation.

COMMISSIONER BROWN: Have you considered upping the charges on savings accounts to discourage this?

MR. NEAPOLE: We have always hesitated to do that because we do want to encourage the people to save. It is a thing that has grown up through the years, and we just do not want to incur any displeasure, so to speak, beyond a certain point by increasing the charges. You cannot go beyond a certain point before you meet resistance.

MR. PATON: I think we might add to that, Mr. Brown, that this would be a poor time at which to increase charges when we find trouble in maintaining our relative position in respect to the overall savings of the country. While the personal chequing accounts have been disappointing in total we have found in our bank that they have not been entirely unsuccessful. We have found that it depends upon the manner in which the individual manager accepted the new innovation. I think that is probably true of everything. It is probably a question of individual salesmanship.

COMMISSIONER BROWN: All of the banks have gone into short-term notes -- 30 days to 364 days -- which are a form of savings accounts which do not have chequing privileges, and at least one bank has gone into longer term notes. Why haven't the other banks followed suit? Do they not like to do it?

MR. NEAPOLE: On the very long term?

COMMISSIONER BROWN: Up to five years.

MR. NEAPOLE: We bid on them over a year, but we don't issue a certificate such as the other banks do. We will bid on money beyond a year.

MR. PATON: I think one answer is the rigidity of our lending rate. It puts a limit on the cost of these funds to us, and as a natural result we are limited in the type of the deposit we can go after.

COMMISSIONER BROWN: I would have thought that if you were able to convince this Commission to raise the ceiling on the lending rate you would go after this money.

MR. PATON: It might be presumptious for me to suggest that.

MR. WADSWORTH: We might suggest that there are some marked differences in banks, in how they approach these things, and in their asset portfolios.

COMMISSIONER BROWN: Would this not give you room for more flexibility on your asset side, if you had long term deposits?

MR. WADSWORTH: Subject to what Mr. Paton said as to the rate of interest we could charge, particularly as related to the loan segment on the assets

[illegible]

gone into [illegible]

which [illegible]

circuits [illegible]

have longer [illegible]

followed suit? [illegible]

MR. [illegible]

"[illegible]

MR. [illegible]

but we don't [illegible]

do. We will [illegible]

MR. [illegible]

eligibility of our lending [illegible]

cost of these funds to [illegible]

are limited in the type [illegible]

[illegible]

if you were able to [illegible]

the ceiling on the lending [illegible]

[illegible]

MR. [illegible]

suggest that.

MR. [illegible]

are [illegible]

approach [illegible]

[illegible]

room for more [illegible]

and [illegible]

MR. [illegible]

[illegible]

side.

COMMISSIONER BROWN: Is it fair to ask why the other banks have not gone into this field, or are you all reluctant to express opinions?

MR. NEAPOLE: We do bid for money beyond a year, without having a set instrument as the Bank of Nova Scotia has.

MR. WADSWORTH: I think some have given it more prominence in their planning than others have, Mr. Brown.

COMMISSIONER BROWN: What do you think would happen if chequing was prohibited on savings accounts?

MR. PATON: I think if chequing were prohibited on individual savings accounts it would result in reducing the handling cost of the accounts in the bank, and undoubtedly, in line with our thinking normally, this benefit would accrue back to the depositers probably in the form of higher interest rates. The impression we have received from P.C.A. is that Canadians have been used to the chequing privilege on savings accounts, and are disposed to continue doing so. We therefore are quite satisfied to continue to permit them to do so.

THE CHAIRMAN: They have also been used to over-drafts?

COMMISSIONER BROWN: What I am leading up to is the suggestion that has been put forward in one or two places, that you might have a different reserve ratio on demand deposits and on notice deposits. I would like to have a little discussion on that.

DR. McLEOD: Perhaps I could speak to that, Mr. Chairman. But before doing so may I say that there are a number of things of a technical nature such as this one, which in some instances may run close to policy. In speaking to this question I would try to make it clear that I am speaking primarily from the technical side that I see would be considered by management in making the decision. This would not necessarily be the only consideration, because this would have to be set against other practical aspects.

In this particular case, as to the possibility of lowering reserve requirements against saving deposits, I think the banks are agreed that a lower overall reserve requirement would be desirable and would enable them to compete more effectively for the savings deposits of the public. This would be primarily as a matter of equity.

It is true that making a lowering reserve requirement on saving deposits alone would be one way of accomplishing this. We feel this would be less satisfactory than a lower reserve on total deposits, because there are certain practical reasons that make it convenient to have a single ratio for all deposits.

However, there are some other aspects of the matter which make it difficult to offer a recommendation unless it is related to a specific requirement, because part of what is involved here surely is the competitive position of the banks in obtaining the savings of the public in competition with other savings institutions. Much would depend on what was done and what was

considered possible to do to ensure a more equitable arrangement in this respect; that is, to place the banks in a more nearly comparable position with other deposit institutions or other saving institutions in attracting the savings of the public.

May I repeat what I think has been said here several times; when we say competitive conditions, we mean fairly competitive conditions. When we are looking for certain obstacles to be removed for ourselves, we don't mean to put obstacles in the way of others, for our own advantage. We are looking for a fair field, and no favours.

COMMISSIONER BROWN: Can you suggest a practical way in this in which such a differential of reserve ratio might be operated? One that comes obviously to mind is that it be measured by the hard core which does not turn over and on which interest is paid. Is this a practical way of looking at it?

DR. McLEOD: Mr. Chairman, I would be reluctant to express an opinion without looking fairly carefully at a proposal, because it seems to me that the question of reserve ratio is only one aspect of an equitable consideration. It is perfectly true that these institutions differ among themselves and that they differ from us. I think therefore one would want to be careful about rushing out and saying that such and such a formula would solve these inequities and would not introduce some others. I think the suggestion you make merits consideration and attention, although some consideration should be given to the point I

have mentioned in terms of finding a formula that is convenient and practical to use.

One might conceive the formula that would be perfectly fair in principle and be extremely difficult to apply, because it would require computations and devices that were not available promptly or would leave uncertainties. So, I would not want to say more than that one would want to look fairly carefully at what specific proposals were made.

MR. HACKETT: If I may follow along with that a moment, I am speaking now, Mr. Brown, from the standpoint of cash management. I believe that on general grounds it is desirable that a cash management ratio system should be as simple as possible and not subject to complicating factors. One of these complicating factors that can be envisaged is the effect on reserves of notable shifts between savings deposits and demand deposits, although the total of deposits does not in itself change.

I am thinking of the kind of irrelevance that might be introduced into monetary control and reaction to cash ratios, and the sort of situation where at one time savings deposits might suddenly go down. The Canada Savings Bond campaign is perhaps the best example I can give where there is temporarily a shift in the savings and demand deposits.

I think from the standpoint of cash management there would be objections to a system that might be complicated or complicating.

COMMISSIONER LEMAN: Are there shifts, Mr. Hackett, in fact between savings accounts and current accounts, large shifts?

MR. HACKETT: There may be, depending to some extent on the condition of the business cycle at any one time. Under boom conditions, with an expansion of commercial credit, demand deposits might tend to run heavy on savings deposits.

Sometimes the reverse situation might occur and then in any one year there could be shifts as a result of payments in and out of the federal treasury, tax payments. The Canada Savings Bond shift was probably the most prominent of the situations that I can call to mind now.

COMMISSIONER LEMAN: Well, if there was a shift towards current deposits instead of savings deposits in times of boom, and presumably the cash ratio would be higher for the current deposits than for the savings deposits, that would run in the right direction from the point of view of the monetary authority, would it not?

MR. HACKETT: That is true, it might.

COMMISSIONER BROWN: You say it might.

MR. HACKETT: Well, I was thinking of a secondary follow-up later. This is perhaps getting into rather abstruse considerations, but if savings deposits were then to build up as a result of increased incomes generated, then you might have a somewhat perverse effect somewhat later in the cycle.

There are all kinds of considerations that come into these shifts. I was merely endeavouring to set the general principle that a single ratio can probably accomplish anything that a split ratio can, without the danger of perversities.

DR. McLEOD: Mr. Chairman, Mr. Hackett has already pointed out one important example of a Canadian case where there has been a distinction in

a quite important seasonal shift from savings to demand deposits, and that is at the time of the Canada Savings Bond campaign.

I think the experience in the United States -- and by the way their ratio requirements operate a little differently -- has been in former times rather the contrary, especially in times of cyclical demands for funds. There was, in fact, a tendency to move deposits into what we might call a nominal kind of deposit in order to get lower reserve requirements, and this proved to impose a complication in monetary management. In their revision of their legislation some thirty years ago, they took some steps to make a very sharp distinction between demand deposits and time deposits, and so on.

COMMISSIONER BROWN: It seems to me that the cost of paying interest on current funds which were switched to a savings account would more than offset the loss of interest on the additional reserve ratio required.

DR. McLEOD: Yes, Mr. Chairman, I think this is probably so, although it naturally depends on just what rates of interest are involved and what ratios and time deposits are involved. I must say I do not recollect from memory what the reserve requirements were in the 1920's which, I believe, was one of the periods in which this was important, but reserve ratios in the so-called Reserve City Banks have ranged by around 18 to 20 per cent at times,

whereas the rates on time deposits have been only 3 or 4 per cent, or at least even as low as that. There is quite a substantial margin in there, especially if the rate of interest on the prime deposits was not particularly high. It depends on what figure you put in here and what figure you put in there as to the formula that comes out.

COMMISSIONER BROWN: But you take it, though, that it is the considered view of the Canadian Bankers' Association that they prefer a single ratio?

MR. MULHOLLAND: That is right.

THE CHAIRMAN: We shall adjourn now until 9.15 tomorrow morning.

--- Adjournment.

Ottawa, Ontario,
Wednesday,
January 16, 1963.

--- At 9.15 A.M. the hearing resumed.

THE CHAIRMAN: I shall call the meeting to order.

MR. MULHOLLAND: Mr. Chairman, with your approval, sir, we would like to supplement certain comments we made yesterday on the subjects of government guaranteed loans and the Industrial Development Bank.

THE CHAIRMAN: Yes.

MR. WADSWORTH: May I carry on, Mr. Chairman? I shall be very brief on this point, but relating to the questions that were directed to us yesterday, in case there was any doubt in the minds of anyone, there were three points I should like to mention again as far as I am concerned.

The first question related to government guaranteed loans and, as I understood the question, would the banks lend significantly less if there was not the guarantee?

It is my view that in an important area such as the Farm Improvement Loan field that the banks,given the power to take the required security, would not lend significantly less. I think the record would show, and I am quite sure figures could be produced to prove this, that the banks have lent extensively to the farm group over the years both in

eastern Canada and in western Canada in new development areas. As far as we are concerned, we would much prefer to lend without the guarantee and feel that this would not affect to any significant extent the volume of any such loans.

As to Home Improvement Loans, I think the question was raised: In the light of trends that have taken place in some of the other government guaranteed loans, why has there not been as much of a notable increase in the Home Improvement Loans?

They have remained relatively steady in the last few years, although the figures for 1962 -- because all we submitted were figures up to 1960 -- do show, I believe, an increase of up to $70 million or about $14 million for the year.

I believe the point was made yesterday, and we would like to stress it again, that there is now, with the volume that we have in our books, a steady cash throw-off or cash flow from repayments. As an example, we have made approximately 227,000 Home Improvement Loans, since they were introduced, in the total amount of nearly $270 million. I would point out that from the volume now on our books we still make, we believe, a significant number of new loans each year, even if the total does not show a marked increase, although, as I say, it did in 1962 over 1961.

My further comment related to the Industrial Development Bank and here again I wish to state, as I endeavoured to do yesterday but probably

not as clearly as I might have, that it is our view that if we were given again the power to take the required security, the flexibility of interest rates -- and of course subject to the availability of funds -- we could well entertain and look after the type of lending that is now undertaken by the Industrial Development Bank.

This might be in some cases supplemented by other private lenders, but we do feel that the role the Industrial Development Bank is now filling could well be filled by the banks and other financial institutions.

MR. MULHOLLAND: Mr. Chairman, the views expressed by Mr. Wadsworth on Farm Improvement Loans, I think I am safe in saying, are the views generally of the Association. His comments regarding Home Improvement Loans would also, I think, be made by all the general managers of the banks. However, I believe some general managers would like to express further views on the subject of the Industrial Development Bank.

MR. BOYLES: Mr. Chairman, I appreciate the remarks that Mr. Wadsworth has made with regard to Farm Improvement Loans and Home Improvement Loans. As to the Industrial Development Bank, as I said yesterday, they are in a position to assume risks that the chartered banks cannot assume, and if the I.D.B. operated under its original terms of reference they would continue to serve a very useful purpose in the economy.

MR. NEAPOLE: Mr. Chairman, I certainly agree with Mr. Wadsworth on the first remarks about the Home Improvement Loans and Farm Improvement Loans, but I disagree with him with respect to the Industrial Development Bank. Although I am not trying to, so to speak, turn this into a C.B.A. meeting, the way we sometimes talk, nevertheless I think if we look at the preamble of the Industrial Development Bank and realize its objectives, it will be seen there is definitely a place for it in the economy for various reasons. It is easy very categorically to say that we could take over its functions, but I do not believe that myself. I believe it serves a very useful purpose.

MR. PATON: If I might add to that, Mr. Chairman, I should like to also subscribe to the comments of Mr. Neapole and Mr. Boyles. It is our feeling that the Industrial Development Bank has served a useful function and would continue to serve one, notwithstanding the abilities of the banks to participate more freely with regard to interest rates, and their powers to take security.

COMMISSIONER BROWN: May I ask a question, Mr. Chairman? Yesterday in discussing the Farm Improvement Loans, Mr. Harrold asked, if under the conditions that the guarantee were removed, would the rates go up and by how much? The loss experience being .19 per cent, Mr. Harrold asked whether the rates would go up more than the loss experience. I think we might get your views on record in this context.

MR. WADSWORTH: I would have to answer,

Mr. Brown, as I endeavoured to answer yesterday, that I think without the government guarantee, yes, I agree that the rate would no doubt be higher, under present conditions.

I mentioned this yesterday, and I think it is borne out by the fact that the banks have continued to lend quite actively in this field at a rate well below the current rate for comparable loans in the light of the guarantee.

I would suggest it is unreasonable that we carry on in this way indefinitely, but as to what the change in the rate would be, I think that the rate would fall in line with rates that were applicable at the time to loans to individuals, farming groups, for that type of operation.

I do not consider that the loss experience ratio or percentage would be used in calculating the new rate, although I think it is quite fair to say -- and it is one of the reasons that make me think there would not be a significant drop with the experience the banks have had -- that the loss ratio has been very small. You have probably seen that in the reports published on activities of the Farm Improvement Loans.

COMMISSIONER BROWN: May I ask a further question, and that is what have you against the government guarantee?

MR. WADSWORTH: I suppose that no lender has anything against a good, undoubted guarantee for a loan. In this case there would be

two figures with probably one being more important than the other. I think that where facilities can be provided from the financial community, whether it be banks or other lending institutions, et cetera, without the necessity of a government guarantee or something behind it such as that, then it is probably better and, while this term has been used many times, a sort of free enterprise play would come into being, if the facilities are there, and I believe they are.

COMMISSIONER LEMAN: Is it, Mr. Wadsworth, that under any guaranteed system the price tends not to be the market price but some arbitrary price.

MR. WADSWORTH: That is very often the case. On the other hand, it should be related to market prices having in mind that under certain forms of guarantee your security position is obviously improved, so that in the scale of rates it would probably go lower down than an unsecured loan.

MR. NEAPOLE: May I interject there?

THE CHAIRMAN: Yes.

MR. NEAPOLE: When this Farm Improvement Loan scheme was started the banks' prime rate was $4\frac{1}{2}$ per cent, and the rate was set at 5 per cent. It is, of course, still at 5 per cent, and the prime rate has gone up to 6 per cent in the meantime.

COMMISSIONER LEMAN: Mr. Chairman, if we might change the subject now and talk about

monetary policy a bit, it has been represented to us both orally and in writing that shifts in monetary policy have come in recent years rather suddenly. We must admit that under numerous sets of conditions every element in the market will not necessarily agree with incipient policy by the monetary authorities. One is entitled to his own judgment. There would be a degree of unanimity only when special considerations entered into the picture which made it obvious that things had to go just one way. But there have been quite a few times when there has been room for argument.

What I should like to start asking you about is whether these shifts in monetary policy necessarily have to come as much as a surprise, especially to the chartered banks? Presumably the banks have economic departments and form their own opinion from time to time on the state of the economy and the likely trends that are about to set in from time to time.

Is there a feeling that in Canada there is some lack of statistical information, economic analysis, that perhaps the statistics, the figures, that the monetary authorities look at in Ottawa are not the ones that are quickly enough available to you as bankers?

DR. McLEOD: May I speak to that, Mr. Chairman?

THE CHAIRMAN: Yes.

DR. McLEOD: This is a question that is

of continuing concern to the banks. It is certainly true that we, like all institutions, can always use additional statistics. Perhaps what is more important is that we have statistics that are available more promptly.

I suppose, however, the ideal will never be achieved, that there will always be room for improvement. It is in terms of predicting what is going to come about in these ways, I suppose, that we as banks could claim that we are not particularly worse, at any rate, if not particularly better than other people in foreseeing what is going to happen.

We do have certain peculiarities in that, with the rigidities in the system, it is rather -- very difficult to predict the loan demand that will come upon us. It is relatively easy -- I stress the word "relatively" because it is pretty well impossible to get close to perfection -- to get some idea of the general course of the economy, but under certain circumstances, when the market breaks, for example, to get above our rates, there tends to be a dumping on us of demands that is rather unpredictable, and this is an area in which perhaps a relatively small change in the rate would have a substantial effect in diverting a considerable volume of demand from one section of the market to another. Surely, a specific example would be in the summer of 1959, and in this past summer, when rates in other sections of the market got high. This, surely, was a

factor in the volume of demand coming on the banks. That sort of thing is really extremely difficult to predict.

May I also say, Mr. Chairman, there is one consideration here in which even we as economists tend to get trapped in some of the limitations on what can be done. We have to work with the factors that can be treated in fairly concrete terms, and certainly we recognize that expectations and anticipations are very important in a situation; but this is pretty difficult to foresee because it depends so much on human judgment and human susceptibilities. I think there is ample evidence of the way in which opinions can swing very quickly, even in very narrow and concrete circles such as the security market. The judgment of one day may not be the judgment of the next.

I submit this may have some bearing, incidentally, on complaints that one sometimes hears on the monetary policy. You say that timing is very important, that if you could only see this thing coming in time, that surely the monetary authorities ought to be able to anticipate this and swing.

Well, I think this inability to deal with expectations may be a factor we are overlooking there. In other words, the situation may just change under your feet before you can do anything. I say this not merely in defence of the central bank but because this does have a bearing on our positon too.

This is one of the reasons why it becomes difficult and we must not expect too much in the light of being able to anticipate these things. We can certainly anticipate them and be prepared for them, but there are limits as to how accurately you can anticipate movements. You can say, for example, that something is likely to happen, but will it be a little or a lot? It is a very difficult thing to answer.

COMMISSIONER LEMAN: Dr. McLeod, besides having this statistical information, which everybody else has in the country, would it be fair to say that the banks have about the best information system, through their very elaborate branch network from every corner of the country and that there must be a feed-back of information both on business conditions generally and on incipient changes in demands for loans.

Are you suggesting that one of the problems about the system when there is a policy change by the monetary authority is that sometimes the first signals induce a perverse reaction in the economy?

DR. McLEOD: This is what happens.

COMMISSIONER LEMAN: So the first reaction is often one of increased demand for loans when you want exactly the opposite?

DR. McLEOD: Yes, indeed. I did not quite answer your point about sources of information. Yes, I think this is quite true, that we do have very

useful sources through our branch managers. Again in this imperfect world we do not succeed in making perfect use of the information but it is certainly a help.

COMMISSIONER LEMAN: Are you suggesting that there would be any way for the monetary authority, any device available to it, which would circumvent or prevent this initial perverse reaction?

DR. McLEOD: I cannot think of any except, I suppose, in a very general sense, but I think this is something that the banks as a whole feel quite strongly about, that there is need for very much more in the way of public information as to what the whole story is all about, what monetary policy is expected to do, what it can do alone or in conjunction with other policies, its limitations as well as its potentialities, particularly inasmuch, Mr. Chairman, as these things, while it would be extreme to say they have lain dormant for a long time, have certainly not been extensively used for long periods. It is only in the 1950's, one might say in the last half of the 1950's, that monetary policy began to be used again very effectively.

I certainly think we must recognize that any machinery, however good, is going to get a bit rusty unless used, and certainly it seems to me that this is a situation in which public education is very important. I would say from the point of view of the fiscal authorities, the government as well

as the central bank, it is simply a question of making sure that people have a reasonably agreed view of what can be expected of various policy techniques.

MR. LEMAN: It has been suggested to this Commission that it would be good for Canada to have some kind of super economic council drawn from all areas -- the business world, the academic world, government, etcetera -- and that such a council could get together and form economic policy for the country. Would you recommend such a thing?

DR. McLEOD: Well, Mr. Leman, this is getting into an area where I would have to speak with caution. Certainly, as an economist, I think this would be a fine thing, especially if greater use could be made of economists. Beyond that I would say that there would be policy considerations there in respect of where decision lay, and I think it would have to be rather carefully thought out as to what were advisory capacities and what were decision-making capacities.

COMMISSIONER BROWN: Mr. Chairman, I wonder if we could have a short discussion on cash reserves and the methods of calculating them. I would like to make this distinction at the moment, that we are not in this context, discussing whether 8 per cent is right or not, or whether the liquidity reserve is right or not, but more the methods of calculating the cash requirements. There are several paragraphs on this. In paragraph 47 you come out in favour of the present system. You say there are some criticisms, but in paragraph 55 you refer to the possibility of their being some disadvantages. You say:

"On balance we consider the advantages of fixing the cash reserve requirement in

advance and averaging reserves over a calendar month outweigh the disadvantages." What disadvantages are you referring to there?

MR. HACKETT: Mr. Brown, I think in that context what we were doing was giving the net result of our views with respect to the present system as compared with a number of alternatives. We arrive at the conclusion that as compared with various alternatives, such as using a different averaging base and a somewhat different averaging period, the existing system seemed, from the practicalities of the matter, well fitted to day-to-day operations, and led to about as smooth responses as it would be reasonable to expect.

COMMISSIONER BROWN: In other words, there are no disadvantages, as you see it. You refer here specifically to disadvantages. Were you thinking more of criticisms than disadvantages? I do not worry about words, but ---

MR. HACKETT: I agree with you. The word should be "criticisms".

COMMISSIONER BROWN: I was not worrying about words, but I wondered if you had some ---

MR. HACKETT: No, I think a better choice of word there would have been "criticisms".

COMMISSIONER BROWN: Can we have your view as to whether it would be more advantageous or whether there would be problems if this was done ignoring till money? In other words, the thought here is that there might be a lower percentage than 8 per cent, no matter what it might be, and that it applies only to

deposits with the Bank of Canada, and that till money would be ignored.

MR. HACKETT: Well, there are swings in till money such as at pay periods during a single month. There are seasonal swings in till money and holiday seasons -- Christmas particularly. I would suggest that ignoring till money would introduce an element of discontinuity, and a complicating element, into the picture. If we can avoid it by the present system then why not do so.

COMMISSIONER BROWN: This would add complications?

MR. HACKETT: I think it would. It would depend to some extent on the reserve base, but on balance I am inclined to that view.

COMMISSIONER BROWN: If the reserve base was still based on the past -- on your deposits -- do you see?

MR. HACKETT: Yes.

COMMISSIONER BROWN: At the moment your 8 per cent, which is based on deposits in the past, refers to some cash you held in the past plus some cash you hold now -- that is right, is it not?

MR. HACKETT: That is right.

COMMISSIONER BROWN: This other method would then mean that the requirements of the base based on your deposits of the past ---

MR. HACKETT: I think a good deal of careful back tracking and careful analysis would be required before you could come up with any precise indication

of the effect, but on balance it might lead to somewhat greater discontinuities as between the reserve base when the change comes between one month and another. That, Mr. Brown, is a rather offhand opinion. I have not had an opportunity of checking it out statistically because the question of the till money is something which we have rather accepted. I do not think it has been very prominent in our thinking.

COMMISSIONER BROWN: In other words, it is operating?

MR. HACKETT: Yes.

COMMISSIONER BROWN: I have one other question. Does the use of juridical days rather than calendar days in your averaging result in any pressures towards the weekends?

MR. HACKETT: I should not think so, sir. It is rather difficult to disentangle that from the effect of the weekly bill tender which happens to come on a Thursday, and the effects on your cash of the action you take with respect to that bill tender are not apparent until the following Monday. You buy bills on the tender for settlement Friday, and your clearing loss arising out of that transaction takes effect on Monday morning. I would not think that the use of juridical days rather than calendar days introduces any complicating factor, really.

COMMISSIONER BROWN: I am just thinking aloud, but does this, in fact, mean if you increase your bill holdings that you get the advantage of the weekend without having to put up the cash for it?

MR. HACKETT: Conversely, if by reason of pressure we have to sell bills on Friday to reduce our bid on the tender below the amount of the bills we have maturing then the converse effect occurs, and I would think it evens out.

COMMISSIONER BROWN: Would there be any disadvantage in moving to calendar days in your averaging?

MR. HACKETT: That is something on which I would not like to give an offhand answer. It would level out the averaging period to some extent. We would have, roughly speaking, eight more averaging days in the month. I think it might introduce certain complications in the sense that there would be two days in your average which you are powerless to affect. There is nothing you can do about those days. They are counting for you or against you, but you cannot take any action which will affect Saturday or Sunday.

COMMISSIONER BROWN: Do you know historically why juridical days were chosen?

MR. HACKET: No, I do not.

COMMISSIONER BROWN: Does anybody?

DR. McLEOD: Mr. Chairman, I suggest it would appear that it was on the grounds that juridical days are the only days on which you can do something about it and, therefore, it would be reasonable to make the averaging on this basis. I believe this is not the practice in the United States, where it is done on calendar days, and I would suppose that people in drafting this legislation might have taken a good, hard look at the American practice and concluded that it

could be improved upon, because if you were stuck with low cash on Friday you were stuck with it for three days. Of course, you did have the benefit of three days, but I think this would introduce imponderables into the calculation, and I do not see any advantage to be gained. It would seem to me that the point Mr. Hackett has made about getting value for the securities you buy or sell is independent of that.

MR. LORENZO HEBERT: May I suggest that it would be very awkward if the last day of the month was a Saturday, and you had to make your calculations on a Friday. There might be a kind of compounding effect there.

COMMISSIONER BROWN: The American system, as I understand it, goes from Wednesday to Wednesday on an averaging calendar day basis. I was really trying to find out why a different system was chosen in 1954 when it was established.

Now, the Bank of Canada's brief has been out for some time, and you have all read it, I assume. There are some comments in it about cash management. I wonder if you have any comments on that? They refer to the ratchet principle.

MR. HACKETT: Yes, sir. By that reference we assume that what is meant there is the suggestion that the existing formula permits or makes possible certain discontinuities in reserve requirements by reason of the change in the reserve base from one month to the next month. There is an abrupt change as you move into a new month and go on to a new reserve base.

We are inclined to think that the significance of that change is not large in any event, but that perhaps more fundamentally the important point in this context is the point that is made in paragraph 39 of the Bank of Canada's brief which is that in any given month the important question is not the absolute level of cash reserve requirements but the difficulty or ease with which the banks are able to obtain their cash reserve requirements, and, of course, this is an element which is very much within the power of the central bank to control.

We do not think that the mere fact that next month the required reserve base will be a little bit greater or a little bit less than that of the calendar month becomes a matter of any major significance. The banking system, indeed, the whole money market, which is very sophisticated in this respect, knows on the basis of the weekly statistics the direction in which deposits are moving, and, as we have already suggested, the central bank can always offset to the extent it wishes the effect of the resulting changes in required reserves.

We might add there that whatever system or base it might prove practical to use there always will be changes in that case if the deposit levels change. So, we come back in our thinking to the point that it is the scarcity or abundance of cash in relation to the reserve base which is the thing that really matters.

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wholly useless.

base -- and I would like to make it clear that I am not referring here to the length of the averaging period; I am simply referring to the base -- would not eliminate uncertainty because we would always, as now, have the problem of assessing the reaction of the central authority to the required base, whatever that base might be.

COMMISSIONER BROWN: In discussions with us, the Governor of the Bank of Canada suggested it might be an improvement to shorten the averaging period to a two-week period. I assume you have some comments to make on this.

MR. HACKETT: Yes, sir. Well, it is a matter to which we have given a great deal of thought. The short answer is that in our judgment -- I am going to take for the sake of argument a two-week averaging period as against the present four-week period -- a two-week period would add to rather than reduce the difficulties of response to central bank action. That judgment was reached on an assessment of a good many technical factors having to do with one's ability to respond in the money market. It depends upon some structural difficulties and procedural difficulties. I do not want to weary you with a mass of detail, but these details are practical, and if it is your wish I could recite some of them.

COMMISSIONER BROWN: I think that would be very useful.

MR. HACKETT: Well, in our thinking on this matter we start from one point that is already apparent

and to which reference was made, I think, by Mr. Leman some days ago. It is a matter of fact and not opinion that over a ~~month the~~ system as a whole is able to work very closely to the 8 per cent reserve base. It is averaged out over a month, and it has gotten now so that 8.1 is a pretty characteristic average. 8.2 is rather the exception. I think that on the basis of last week's figures the cumulative average -- and this is a rather short period, January 1 to January 9 -- was 8.09, but the system now seems to be able to work at around 8.1.

That, of course, does not rule out the possibility of swings in that overall average at different times of the month, and it certainly does not rule out the possibility that any time in the month one bank is going to have a higher cash ratio than another.

That, we suggest, is one of the facts of life in banking, and it arises, of course, by reason of the fact that the payments which our customers wish to make do involve rather large movements of cash from one bank to another. From a practical point of view I think all of us are faced with situations some mornings in which we are subject to a cash gain or a cash loss which might be of the order of 1 per cent, or sometimes more, in terms of our reserve ratio requirements. I think possibly these swings may -- and somebody else here may wish to say something about this -- be a little more exaggerated in respect of the smaller banks.

COMMISSIONER BROWN: Could I interrupt and get a clarification? That figure of 1 per cent, is this 1 per cent of the 8 per cent or as between 7 per cent and 9 per cent?

MR. HACKETT: As between 8 per cent and 9 per cent, or 8 per cent and 7 per cent, or it may be 8 per cent and 6½ per cent.

COMMISSIONER BROWN: The way you put it, I thought it was 1 per cent of the requirements.

MR. HACKETT: Oh no, 1 percentage point in terms of the reserve ratio itself. $30 million or $40 million is not -- and sometimes even a larger amount -- is not out of the way for a clearing gain or loss.

COMMISSIONER BROWN: I thought that was what you referred to, and I wanted to make it quite clear.

MR. HACKETT: Well, in cash management that turns up every day, the problem of taking action to counteract these swings in one way or another. I speak with some personal feeling on this because I happen to live in this area.

The action one takes involves some knowledge of immediate future developments, some guesses, and after one has done one's best guessing, there is still a wide area of the unknown. We don't know what everyone is going to do; we don't know what the customers of other banks are going to do; that is, the action one wishes to take.

The action that onecan take depends on the capacity of the money market in its turn to produce

the result that one is trying to achieve. What I have just said, sir, probably implies that in our opinion the money market has some limitations and that it may from time to time be in a position in which its responses are not adequate to what a bank -- one bank or a group of banks -- is trying to do.

Just to run down a few of these limitations, let us consider those in relation to a situation in which you have a temporary excess of cash which you are trying to reduce. I think it was said the other day that nothing rings the heart of a banker more than having cash that you can't employ, and any interest is better than no interest.

Well, the obvious thing to do is to try and make day-to-day loans to the money market. What you can do there depends on the size and the demand for day-to-day loans at any one time, and that in turn depends on the size of the inventories of eligible day-to-day loan collateral which the money market dealers wish to carry.

Sometimes that market is large enough, sometimes it is not. Sometimes it is not responsive to rate reductions, and it is logical to expect that if you reduce your rate you will get more day-to-day loans; someone will be at another bank and bring the money over to you, but very often the actual effect of a rate reduction will be a reduction through the piece; money will not move.

I think in that context that we have to recognize that the size of the day-to-day money market is determined by the money market dealers' convenience,

and quite properly; they are doing what comes naturally for them and they are not, quite properly, interested in our problems.

A second dourse of action open to you is to buy treasury bills. There at times the floating supply may be small and dealers may be reluctant to sell, and frequently -- or, I should say not infrequently -- the purchase of bills has a curiously perverse effect. The bank may be faced with an excess of cash, and it goes into the market to buy bills and it does buy bills, and is then suddenly faced with the pay-off of day-to-day loans, because having taken these bills out of the market the financing of these bills is not necessary, and you get paid off and end up about where you were to beging with.

Looking at it from the other point of view, which is the kind of thing you have to do when you are faced with a temporary shortage of cash; well, there again the obvious thing to do is to call day-to-day loans from the money market. The theory on that is very elegant; you call them and the dealer scurries around and finds another lender. If he can't find another bank as lender, he goes to the Bank of Canada and in one way or another you get a clearing gain on another bank.

In actual fact, there has been a new variable in this situation in the last couple of years, which is the existence in the market of what the street, which manages to find a name for everything, terms the "country banks".

These are non-bank corporations, financial

institutions of one kind or another who also make day-to-day loans.

A situation can arise, therefore, when you have called a day-to-day loan and you are not sure you will get a clearing gain, but you may find you have paid yourself off out of your own money if the dealer happens to go to one of these intermediary institutions who happens to have an account with you, and then this is where you come in from the standpoint of the operation.

Selling treasury bills on the market can be limited and at times it is limited, indeed. Either way, whatever you are trying to do, the precision and the response that you get is limited also by lags due to delivery procedures.

The normal bill transaction requires two clear days before there is a cash gain or a cash loss resulting to the bank. Usually a bill transaction on Tuesday is usually ready for settlement Wednesday, which means the resultant change in your clearing position turns up Thursday. Sometimes it is possible to accelerate that one day, but that must be with the consent of the customer; the bank itself cannot do it.

On day-to-day loans there is one day required to turn up a cash gain or a cash loss, if you get one, and in point of fact the only way in which a bank can get same-day cash as a result of any of its transactions is by obtaining an advance from the Bank of Canada and, as you know, that is not a procedure which is resorted to frequently, nor does it appear to be encouraged.

Now, there are one or two other things and

I hope I am not doing this in too great detail, am I, sir?

COMMISSIONER BROWN: No, go on. I have a couple of questions to ask, though!

MR. HACKETT: I am sure you have.

Another factor in this is that there does seem to be in some areas almost a monthly rythym in the movement of certain kinds of payments, certain bulges over a month recur with almost predictable regularity, and certain deficiencies occur, and over a month they seem to average out, and in anything less than a month or more than a month they probably would not.

I refer particularly in that respect to the impact of certain monthly payments in and out of the federal treasury.

I think there is another element in here, that the facts of life in this cash management operation do involve some bad guesses. One can't help but make some bad guesses, but happily they are not all in the same direction and over a month the bad guesses may tend to even out. Over a shorter period the chances would be correspondingly reduced. Whatever averaging period we had on these limitations of the market and the settlements, lags would still persist.

The net result in our opinion, sir, would almost certainly be that with these underlying factors many other irregularities are still there; you can't do anything about these, they are with us, and the shorter averaging period would mean that all banks would find it necessary to run at somewhat higher cash ratios

than they do now.

Now, I have one point to add, sir, and it is this; that if, despite our judgment in this matter, we were compelled to operate on a shorter averaging period, we think that certain procedural changes would be essential to that.

In our opinion we would need a facility for getting at same-day cash; that is, doing something one day and having the cash adjustment take place on that day, and in that respect a market in Bank of Canada funds -- which we don't have now -- might go a long way to meet that problem.

Secondly, we think we would require a revision of the present procedures governing advances from the Bank of Canada; we would need, we think, the elimination of the penalty that attaches to a secondary discount within a month, or as it may be in this case a secondary discount within a shorter averaging period. We would need, we think, the ability to take advances on a day-to-day basis instead of for the full seven days as now applies, and at long last, or finally, we would think that a review of the size of the banks' credit lines with the Bank of Canada would be involved.

I am sorry that this has taken so long, but there are certain elements in this thing that I think it may be well to go over in some detail.

COMMISSIONER BROWN: Thank you very much. One thing I can't understand, and that is if the Bank of Canada is operating its cash on a fairly smooth basis, and one bank is up in the size you mentioned,

[illegible]

[illegible] that time [illegible] matter, we [illegible] we think [illegible]

[illegible]

[illegible] of the [illegible] Bank of Canada [illegible] the elimination of the necessity [illegible]

[illegible] with the [illegible]

[illegible]

[illegible]

is it not a presumption that some other bank or banks are down?

MR. HACKETT: Yes.

COMMISSIONER BROWN: And this would obviate some of the difficulties you mentioned in the market?

MR. HACKETT: Well, we don't deal directly with that other bank.

COMMISSIONER BROWN: But it must come out in the market?

MR. HACKETT: It must come out in the market, and if there are imperfections or limitations in the market, one bank is going to be up more than it likes and for longer than it likes, and the other bank is going to be down more than it likes and longer than it likes, simply because of the difficulty of adjustment in between.

COMMISSIONER BROWN: I did want to bring out that point. There will be this offsetting action?

MR. HACKETT: Quite.

COMMISSIONER BROWN: The point on the delay in getting you a settlement is that the higher the averaging period the higher, percentage-wise, are the rates, and two days on a 30-day average is much less than two days on a ten-day average?

MR. HACKETT: That is right, sir.

COMMISSIONER BROWN: On a small technical point, you did say that the only way you could get cash the same day was by borrowing from the Bank of Canada?

MR. HACKETT: That is right.

COMMISSIONER BROWN: Could you not get cash the same day by delivering till money?

MR. LORENZO HEBERT: No ---

MR. CASE: Yes, you can, but not the quantities.

COMMISSIONER BROWN: I am bringing out a technical point for the record.

MR. HACKETT: In the quantities you can do it;it is not a very practical matter.

COMMISSIONER BROWN: On the question of advances, if a lower averaging period were used it would be an assumption I think, that the penalty rate would again apply to the second bite of the cherry only in the same averaging period, but it would hardly be fair to make it apply in two averaging periods, would it?

MR. HACKETT: We would hope that that would be the assumption, but the matter has not yet arisen.

COMMISSIONER BROWN: Now, I can't quite see the validity of the argument that you must have it on a day-to-day basis. In the United States they average on a week and the loans have to be for the week.

MR. HACKETT: Well, sir, my observation there would be ---

COMMISSIONER BROWN: You must be able to borrow for the Friday and get the benefits for the weekend?

MR. HACKETT: On the basis of a two-weeks averaging period, to have to go in for a week is a little rough, but I think there is a more, perhaps, fundamental point than that. That on the basis of a

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[illegible]

[illegible]

two-weeks averaging period, a bank is put in the position of having to take an advance that it may not need for that week, and if it is in possession of that cash for a week, surely, if anything, the result is that it is adding to the imperfections of adjustments.

COMMISSIONER BROWN: Well, I wanted your comments on that. I understand that the last time the lines of credit were agreed upon with the Bank of Canada was some three years ago?

MR. HACKETT: Pardon?

COMMISSIONER BROWN: The last time the lines of credit were adjusted were some three years ago; is this correct?

MR. HACKETT: I believe, sir, that it goes back a little further into antiquity than that; my understanding is it was some time in 1953.

COMMISSIONER BROWN: And have the banks negotiated no discussions since then to get a change in this?

MR. MULHOLLAND: The answer would be no.

MR. HACKETT: I think no in the sense of a formal presentation, but it may have come up from time to time in individual casual conversations.

COMMISSIONER BROWN: Is it fair to ask why not? They are not large enough?

MR. MULHOLLAND: They appeared to have been large enough for the circumstances of the last few years. We have heard of no case where a chartered bank has been declined an increase in its line of credit.

COMMISSIONER BROWN: As far as the Bank of Canada operations of the cash in the system are concerned, have you any comments on where this has been running?

MR. HACKETT: From a technical point of view, sir, no.

COMMISSIONER BROWN: Now, how do you think that they should operate when they want to make changes; should they make gradual changes? In other words, how do you think cash should be operated by the central bank; should they give you clear signals or should they make gradual changes?

MR. HACKETT: As a general procedure one, I think, can say that a sudden sharp change has its uncertain elements from the standpoint of our reaction to it. If the change is large and if it is reasonably sudden it raises a new trend of thought as to the assessment of the purpose which the central bank authorities are seeking to achieve.

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In our turn, we have to make a judgment as to whether this is a major move or something that is done one week and is likely to be reversed the second week. The change is rather gradual from week to week, moving in the same direction, and it tends to give you a feeling of greater certainty in your response. On the other hand, there are always special situations that arise, and that we are aware of, and we learn to allow for; but a sharp, sudden change in the cash base does raise a whole train of questions in your mind -- What caused it? Is it going to last? Why is it being done? I suppose I should add that a certain element of uncertainty is part of the technique of monetary policy, and that, too, is something we have to live with.

COMMISSIONER BROWN: If the central banking authorities are desirous of giving a clear signal of some kind, how do you think this should come about? Through a move in the bank rate?

MR. HACKETT: A move in the bank rate is one ---

COMMISSIONER BROWN: Through discussions with the banks, through a directive to the banks?

MR. HACKETT: I think that the kind of signal we have in mind here -- and I am sure we are thinking along the same lines -- is the kind of signal that either confirms a certain course which you are following as a banker or which indicates that maybe you had better change your course. I think, sir, it is a mix of a number of

things. A change in the bank rate is one factor; oral communication between the banks and the central bank is another. May I add also that from the standpoint of cash management a pronounced change in central bank policy turns up pretty quickly in the situations with which you are confronted.

Let us say, for example, that one bank, for one week, finds that almost whatever it is trying to do in the money market it can never get its cash as high as it wishes to do. On Thursday morning, when the Bank of Canada balance sheet turns up, you then have the basis for an assessment as to whether it is something peculiar to the individual bank or something general in the system; and if it is something general in the system, and this tightness maintains for two or three weeks, you have a pretty good idea that for the time being the direction of central bank policy has changed.

COMMISSIONER LEMAN: The banks do not exchange signals between them?

MR. HACKETT: I do not quite know in what context you are speaking. Bankers do go out to lunch with each other from time to time!

COMMISSIONER LEMAN: All I am saying is that you have described a set of conditions here that, you say, puzzle a bank.

MR. HACKETT: Yes.

COMMISSIONER LEMAN: When somebody is puzzled, presumably he can discuss it with others to see whether they are just as puzzled or not.

MR. HACKETT: This is all a very tight little financial community. There are also the money market dealers. They know what the banks are trying to do, and word soon gets around. Money market dealers feel responses, too, of banks, in their reactions to the market. Shall I say, the word quickly gets around.

COMMISSIONER BROWN: Well, are you satisfied with the present sort of signals that do come into the market? Do you think this is all right, that the market is kept on edge to a certain degree, and yet there are facilities for giving a pretty clear signal if it is required?

MR.HACKETT: Perhaps I should answer that this way, that one always wishes one had a clearer signal. On the other hand, I do not think that automation has got so far yet that we can expect push-button banking or push-button central banking. There has got to be an area of uncertainty.

COMMISSIONER LEMAN: I would like to ask Mr. Hackett: You have described for us the short lags due to settlement practices in the market, delivery and settlement practices. Do you see a way that would be practical, that could speed all this up, and that would be of real value? Is it handled more quickly, say, in the New York market than it is up here in Canada?

MR. HACKETT: I am not familiar with all the techniques. If I might just switch the area of the question: In London, by reason of the

MR. [illegible]: ... it is all a very tight little financial community. There are about [illegible] [illegible] are trying to do, and more than [illegible]. Money market dealers [illegible], [illegible], on their reactions to the market. So I'd say, the word quickly gets around.

COMMISSIONER [illegible]: [illegible] you satisfied with the present sort of signals that do come from the markets? Do you think this is all right, that the market is kept [illegible] to a certain degree, and yet there are facilities for getting a pretty clear signal if it is required?

MR. [illegible]: Perhaps I should [illegible] that this way, [illegible] one always [illegible] one get a clearer signal. On the other hand, I do not think that information [illegible] expect quick-action back of [illegible] central banking. There has got [illegible] an area of uncertainty.

COMMISSIONER [illegible]: I would like to ask Mr. [illegible]. You have described for us the short lags due to [illegible] in the market, delivery and settlement procedures. Do you see a way that could [illegible] this to, and [illegible] changes more quickly [illegible] than it is [illegible]

MR. [illegible]: I [illegible] all the technical [illegible]

high concentration of financial transactions in one city and, indeed, in one very small area, they do have what is known as the "town-clearing" system, where financial transactions can be cleared and settled on the same day. A bank in London can, I believe, call a loan in the morning and have the cash on its books that afternoon -- I think, by half past three. However, I think that arises out of the fact that you do have a very close concentration and you are not spread out the way we are here.

COMMISSIONER LEMAN: This technique of having a market in same-day cash, Bank of Canada cash, what would stop the banks from creating this market themselves?

MR. HACKETT: Well, I think there are two factors that arise there. One is that the Bank of Canada has, I think, fairly definite views on this matter. I think the Governor of the Bank of Canada went into that in some little detail on one of the days of his appearance here. A more directly related point is that cash is your balance on the books of the Bank of Canada to a large degree, and the co-operation of the Bank of Canada would be required on the market for same-day cash.

COMMISSIONER LEMAN: Would you explain this last statement? What co-operation would you need?

MR. HACKETT: I think the Bank of Canada would have to consent -- and we have not thought through the technicalities of this thing in

[illegible] interpretation [illegible] in the [illegible] and, [illegible], [illegible] then do not, what is [illegible] system were [illegible] and [illegible] settled on the same [illegible]. A [illegible] I believe, [illegible] in the [illegible] the cash on the books [illegible] -- I think, [illegible] half past three. However, I think that arises out of the fact that you [illegible] and you [illegible] here.

[illegible]: The [illegible] of having a [illegible] cash, [illegible] cash, that would [illegible] the [illegible] [illegible] [illegible] themselves.

MR. [illegible]: Well, I think there are two features [illegible]. One is that the [illegible] on this matter. [illegible] of [illegible] went into [illegible] one of the [illegible] [illegible] on the books of the [illegible] and the [illegible] [illegible] the [illegible].

[illegible]

this last [illegible]

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MR. [illegible]

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very great detail -- to a procedure whereby transactions in Bank of Canada funds would, in effect, be admitted by them to be in Bank of Canada funds, and would therefore result in a debit or credit on their books on the day on which the transaction occurred.

COMMISSIONER LEMAN: Could it be done right here, in Ottawa, in the morning, with a representative of each bank involved?

MR. HACKETT: Well, I would think of it, perhaps, in a little different sense, sir. There is a principle of anonymity here. Again, I should say that we have not thought this through from the standpoint of their techniques -- step one, step two, step three -- but in my own thinking on the matter -- and other people may have different ideas -- I would envisage a market in Bank of Canada funds as taking place through a chosen intermediary who plays a role somewhat similar to one of an exchange broker; and, indeed, an exchange broker might conceivably be able to take the job on. That would preserve a certain element of anonymity, so that one bank would not be dealing with another bank, but with a broker who would be an intermediary for the whole system.

COMMISSIONER LEMAN: I understood you to suggest earlier that if the averaging period was considerably shortened, in order to make a quickness of response and sharper management of cash in each bank, these things would be needed. I thought you said that.

MR. HACKETT: Yes, I have said ~~that.~~

COMMISSIONER LEMAN: Therefore, you feel

very great details -- [illegible] transactions [illegible] in Bank of Canada funds would, in effect, be granted by them to be in Bank of Canada funds, and would, therefore result in a credit [illegible] their [illegible] on the day on which the transaction occurred.

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MR. [illegible]: Well, I would think of it, perhaps, in a [illegible], sir. There is a principle of [illegible] here. [illegible] I would say that we have not thought this through from the standpoint of their techniques -- [illegible] -- but in my own thinking on the matter -- and other people may have different ideas -- I would envisage a market in Bank of Canada funds as taking place through a chosen intermediary who would be someone similar to one of the exchange brokers and, indeed, an exchange broker might conceivably be able to take the job on. That would preserve a certain element of anonymity, so that one bank would not be dealing with another bank, but with a broker who would be an intermediary for the whole system.

COMMISSIONER [illegible]: I [illegible] you [illegible] to suggest earlier that if the [illegible] was considerably shortened, [illegible] quickness of [illegible] and [illegible] of cash in each bank, these things would be [illegible]. I thought you said that.

MR. [illegible]: Yes, I have said that.

it could be developed that way?

MR. HACKETT: Yes, I am sure it could be developed. But in any procedure you set up there are bound to be certain bugs, and you try to foresee any difficulties, and we have not really got to that point in our thinking yet.

COMMISSIONER MacKEEN: May I interject a request for some clarification? What you are after, essentially, is the transfer of Bank of Canada funds on the same day, and there is no reason why a bank, through one or any number of intermediaries, should not acquire a credit from another bank which, through the clearings, will exchange bank cash. There is nothing to prevent you exchanging cash, but it is the one-day payment, the same-day payment, that is a consideration?

MR. HACKETT: This would be changing cash from one bank to another, without going through the money market.

COMMISSIONER MacKEEN: Or the clearing.

MR. HACKETT: Yes, the clearing, as at present constituted.

COMMISSIONER MacKEEN: Yes.

MR. HACKETT: That is right, sir.

COMMISSIONER LEMAN: You do not feel this would detract from the effectiveness of the money market and its development?

MR. HACKETT: It might, sir, and that is one of the reasons why we would prefer the present monthly averaging period. It might indeed detract from

the effectiveness. The money market would have less to do.

COMMISSIONER BROWN: Have you any suggestions as to methods whereby the change in your cash at the Bank of Canada can be speeded up through normal procedure, instead of having this big delay?

MR. HACKETT: No.

COMMISSIONER BROWN: What are the problems involved? With your customers, you give them credit that day. Why cannot the Bank of Canada give you credit that day? In other words, in the case of a treasury bill the transaction is done today, is arranged today, and it takes place tomorrow, and you do not get the ins and outs, as far as your cash at the Bank of Canada is concerned, until the day after tomorrow. Is there any way in which that can be speeded up so that you can settle the whole thing tomorrow?

MR. HACKETT: I would like to amend my reply by saying: No, from the standpoint of anything the banks can do. The question you asked has a certain historical context.

COMMISSIONER BROWN: We are here to try to change the course of history, if necessary!

MR.HACKETT: Right. I do not know that I am going to try to make it, sir.

There was a time -- and I am a little hazy about dates, because time passes so quickly, but back in the forties, when you could sell treasury

the effectiveness. [illegible]

to do.

[illegible]: Have you any suggestions as to [illegible] the change in your case at the Bank of Canada can be [illegible] through normal procedure, instead of having this big delay?

[illegible]: What are the problems involved? With your proposal, you give them credit that day. Why cannot the Bank of Canada give you credit that day? In other words, in the case of a treasury bill the transaction is done today, is arranged today and it takes about tomorrow, and you do not get the ins and outs, as far as your cash at the Bank of Canada is concerned, until the day after tomorrow. Is there any way in which that can be speeded up so that you can settle the whole thing tomorrow?

MR. [illegible]: I would like to answer my reply by saying: No, [illegible] anything the Service can do. The question you asked has a certain historical context.

[illegible]: We are trying to change the course of history if necessary.

MR. [illegible]: Right. I do not know what I am going to [illegible].

There was a time -- and I think I [illegible] many years, because that process [illegible]

bills to the Bank of Canada, assuming that they wished to buy them. Presuming it was done before one o'clock, you could have same-day cash. You could have that cash on your books the same day. Then we got into a rather curiously split system, whereby if a bank bought bills on the tender on Thursday morning it settled in Bank of Canada funds, which meant that the cash loan resulting from a bill purchase was on your books Friday morning instead of Monday, as is now the case. Or if you ran your bills down and bought less than you had maturing, the cash gain would be on your books Friday instead of Monday, as is now the case.

On the other hand, that procedure did not seem suited to the requirements of the money market dealers who, in turn, had a problem of getting payment from their customers, so transactions with dealers were in clearing house funds. In the opinion of the Bank of Canada, that led to certain inconsistencies, with the result that -- How many years ago was it, Mr. Case?

MR. CASE: I do not recall how many, but some time in the fifties.

MR. HACKETT: Some time in the fifties all bill transactions were put on a clearing house funds basis. These are, as you suggest, techniques that could be worked out by the Bank of Canada from the standpoint of speeding up reactions. But I am bound to say, I do not know whether a Bank of Canada funds basis of settlement would suit the books of the

bills to the Bank of Canada, [illegible] they wished to buy them. Presumably if we [illegible] o'clock, you could have same-day cash. You could have that cash on your books the same day. Then we got into a rather curiously split system, whereby if a bank bought bills on the tender on Thursday morning it settled in Bank of Canada funds, which meant that the cash [illegible] resulting from a bill purchase was on your books Friday morning instead of Monday, as is now the case. [illegible] if you ran your bills down and bought less than you had maturing, the cash gain would be on your books Friday instead of Monday, as is now the case.

On the other hand, that procedure did not seem suited to the requirements of the money market dealers who, in turn, had a problem of getting payment from their customers, so arrangements [illegible] dealers were [illegible] carrying [illegible]. In the opinion of the Bank of Canada, that led to certain inconsistencies with the [illegible] — How many years ago was it, Mr. [illegible]?

MR. [illegible]: I do not recall how many, but some time in the fifties.

MR. [illegible]: [illegible] all bill transactions were put on a clearing house basis. These are, as you suggest, technicalities that could be worked out, [illegible] the standpoint of the [illegible]. But I am bound to say, I do not know whether a Bank of Canada [illegible]

money market dealers. I am inclined to think that probably it would not, because they, in turn, have problems in getting payment from their customers, who would be settling in clearing house funds.

COMMISSIONER BROWN: Earlier we were discussing the question of forecasting, and Dr. McLeod mentioned the problems of forecasting what your demand for loans is going to be, and what influence rates are going to have on your requirements. How far do you find, in a practical way, you are able to work out some sort of forecast of what your loan demands are going to be?

DR. McLEOD: Mr. Chairman and Mr. President, if I may answer that question, I think that all the banks have made some effort in this respect, with at least some degree of success in terms of anticipating normal development. Please do not ask me what "normal" means, because I do not know; but I mean, in terms where it can be related to expected movements in the general economy, various other indicators, and so on. The unpredictable part is in terms of where you get to some critical breaking point, which is not particularly in real terms -- that is, not necessarily related to changes in physical quantities, but rather to reactions to a market situation.

MR. WADSWORTH: I wonder if I might add that from the practical day-to-day point of view in handling these matters, it is obvious banks are most interested in forecasting loan demand, but there

are certain problems, I think, in connection with national banks. In addition to economic factors, we have to take into consideration seasonal requirements that vary quite markedly from one area to another. In saying "seasonal requirements", I am talking of the seasonal requirements of the, in many cases, large groups of small borrowers as well as larger borrowers. You could cite many examples -- of the tobacco industry, or something of that sort -- where you can get a general idea of the trend, but you cannot get a definite idea of the trend where you are dealing with one or two major industries in one area. I think this is reflected in the statistics that are published often by the Bank of Canada -- you are probably aware of them -- of the unused lines of credit. There generally appears to be a large amount of unused lines. The percentage does not vary a great deal, but the banks feel, and experience, I think, has proved, that there is no great risk in this area due to seasonal factors, which I have mentioned, where one area is reaching a peak of its requirements at the time when other areas are paying down. I think this is one of the advantages in the flexibility of a national banking system that can move funds from one area to the other.

However, in taking consideration of these economic factors and the seasonal requirements in certain areas, you have to take into consideration what is happening in certain areas from an economic point of view, where the normal seasonal requirement

[illegible]

agricultural credit. In conclusion, if economic factors,

we have to take into account [illegible] require-

ments that very [illegible]

economic. In [illegible] "seasonal requirements", I am

talking of the seasonal requirements of [illegible] in

many cases. [illegible] small concerns as well

as larger concerns. You [illegible] --

of the broader [illegible] or something of that sort --

where you [illegible] of one [illegible]

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you are dealing with [illegible] major industries in

our area. [illegible] in the [illegible]

tees that are produced [illegible] by [illegible]

you are probably aware of them -- of [illegible] lines

of credit. These [illegible] as a [illegible]

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I [illegible] that [illegible] no great risk

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down. I think [illegible] advantages in

the flexibility of [illegible] banking system that

[illegible]

[illegible]

these [illegible]

[illegible]

[illegible]

might be lengthened out a little bit. For instance, the marketing of certain products may not be as rapid as it is in a normal year. These matters must be taken into consideration too. I am sure that these are given full consideration by all of the banks, but what I am leading up to is that the response to monetary action cannot be, in many cases, as abrupt, from a theoretical point of view, as it may be desirable that it should be, because businessmen, individuals, have made plans. There are these other factors I have mentioned, and it does take a certain amount of time, I think, to bring these changes, desirable as they may be, into effect, without causing any great, undue hardship to one particular area which has already made its plans.

I think this was referred to briefly in the evidence of Lord Cobbold, who mentioned a considerable period -- I think that he mentioned a period of up to six months -- might be required, in view of the commitments that were already outstanding. But this is something we watch very carefully. We think that given reasonable signals from the central bank as to its intentions, and given the tools to carry out the job, such as the removal of interest-rate ceilings, we can respond; but there does have to be a certain time lag.

THE CHAIRMAN: We will adjourn for fifteen minutes.

--- Recess.

THE CHAIRMAN: We shall now resume.

COMMISSIONER BROWN: Mr. Chairman, I just have one question I should like to go back to for a minute, and that is on the problem which has been referred to as the ratchet problem. This seems to arise more particularly on a new issue which all the banks together find particularly attractive, and the central bank does not really know what has happened until delivery takes place, and then, of course, the cash requirement effect is not apparent or at least it does not become effective until the beginning of the next month, or the next month.

It has been pointed out that the Bank of Canada can start squeezing as soon as they see what has happened, which has been reflected in the deposits. But to what extent are their hands tied from the point of view that the only way they can squeeze this out of the market is, in effect, by pushing down the very bonds that have just come onto the market?

MR. HACKETT: I must confess, Mr. Brown, that I find it a little difficult to relate the problem that might arise if the banks in the aggregate bought more bonds of an issue than the Bank of Canada thought they should, which is one point you have raised here.

I find it in my own thinking a little difficult to relate that to the working of any change in reserve requirements of the banks from one

THE CHAIRMAN: We shall now adjourn,

COMMISSIONER BROWN: Mr. Chairman,

I just have one question I should like to go back to for a minute, and that is on the problem which has been referred to as the [illegible] problem. This seems to arise more particularly on a new issue which all the banks consider find particularly attractive, and the central bank does not really know what has happened until delivery takes place. And then, of course, the cash requirement effect is not apparent or at least it does not become effective until the beginning of the next month, or the next month.

It has been pointed out that the Bank of Canada can start operating as soon as they see what has happened, which has been reflected in the deposits. But to what extent are their hands tied from the point of view that the only way they can squeeze this out of the market is, in effect, by catching up [illegible] the new funds that have just come onto the market.

MR. RASMINSKY: I must confess, Mr. Brown, that I find it a little difficult to relate the problem that you [illegible] the banks in the aggregate [illegible] at the time that the bank [illegible], which is one point you have raised [illegible].

I find it [illegible] a little difficult to relate that to the [illegible] of the

month to another. It is probably my own disability, but I was confused myself in the relationship which was apparently placed between those two points. I cannot see that the ratchet effect need necessarily have anything to do with this problem. I am not trying to explain away the problem. It is the context between the two that I personally find confusing.

To turn now to the other aspect of the question: If the central bank is trying to reduce the available cash to the banks in relation to the monthly requirement, whatever that requirement may be, your question then, I take it, is how can you do that without depressing the price of the bond you have already sold? If the banks as a group go relatively heavy into one particular bond issue or into any other form of asset ---

COMMISSIONER BROWN: Pardon me, but it becomes apparent that they seem to move more in unison in connection with new issues.

MR. HACKETT: Well, if that situation occurs, the day after the delivery date, whatever date that is, the banks that have done so will probably find that their cash ratio has been reduced, and to that extent there is an automatic contraction that has taken place by the very reason that they have expanded their assets to the extent of making this purchase.

MR. WADSWORTH: May I add a comment? I am really asking: Is the question based on the fact,

the supposition, that the banks are buying heavily of new issues without having clearly provided in their own minds the resources to take up those new issues? I do not think that would be a fair statement, if that is the case.

COMMISSIONER BROWN: If this is a cash issue, is it not correct that the government deposits are left in the banking system?

MR. HACKETT: That is true.

COMMISSIONER BROWN: In other words, if the banks have bought the bonds, then they have created the government deposits and therefore their deposits have gone up?

MR. HACKETT: The deposit liabilities of the system have gone up, but the cash in the system will not have changed, so there will be a reduction in the reserve ratio. If the cash is constant then the asset side of the banks' balance sheets have risen by reason of the acquisition of the bonds, and the liability side has risen by reason of the corresponding deposits which are in the government account.

COMMISSIONER BROWN: And the cash has not changed?

MR. HACKETT: No, the cash has not changed.

COMMISSIONER BROWN: But the cash requirement for the next month has changed or will change?

MR. HACKETT: That is true.

the proposition, that the banks [illegible] buying heavily, of new issues without [illegible] in their own minds the readiness to take on more new issues? I do not think they would be a fair statement, if that is the case.

[illegible] If that is a fair issue, is it not correct that the government deposits are left in the banking system?

[illegible]: That is true.

[illegible]: It is true. If the banks have bought the bonds then they have [illegible] the government deposits and therefore their deposits have gone up?

[illegible]: The deposit [illegible] of the system have gone up, but the cash in the system will not have changed, so there will be a reduction in the reserve ratio. If the cash is counted upon the asset side of the banks' balance sheets has risen by reason of the acquisition of the bonds and the liability side has risen by reason of the corresponding [illegible] in the government's account.

[illegible] And the cash has not changed?

[illegible]: [illegible] has not changed.

[illegible]

requirement for the [illegible] has changed [illegible]

COMMISSIONER BROWN: And this is the whole problem we are talking about?

MR. HACKETT: Well, in that event, and assuming that no other off-setting factors have occurred, then the Bank of Canada conceptually has a problem in the succeeding month in bringing available cash back more closely into line with cash requirements.

COMMISSIONER BROWN: But the problem of the Bank of Canada, as they outline it, is that the only way this cash can be supplied to the system as a whole is by them supplying it, because you cannot get it one from the other.

MR. HACKETT: That is true.

COMMISSIONER BROWN: And your answer is that they can solve this in part by forcing you to put your deposits down before the next month?

MR. HACKETT: That is right.

COMMISSIONER BROWN: Getting back to the same question, may I ask you how they can do this without driving the bond market down?

MR. HACKETT: Well, any monetary action, if it is large enough and severe enough, is bound to have some effect on short-term interest rates. I am bound to say that I think the problem does really beg the question as to whether banks in fact do make a practice of, in effect, buying heavy in bonds when they do not know how they are going to pay for them. I do not consider that that situation is really apt to arise. We are extremely conscious

whole problem to [illegible]

[illegible]

and assuming that no other offsetting factors have occurred, that the Bank of [illegible] has a problem in the [illegible] available cash bank [illegible] cash requirements.

[illegible] of the Bank of [illegible] the only [illegible] this case [illegible] as a whole [illegible] get it [illegible].

MR. [illegible]. That is true.

[illegible] is that they get [illegible] this [illegible] to put your [illegible].

MR. [illegible]. That [illegible].

[illegible] the same question [illegible] this [illegible].

[illegible] addition, [illegible] is [illegible] rates. [illegible] does [illegible] in [illegible] particular [illegible]

of our cash requirements and our probable cash requirements when we make commitments for a new issue. As a matter of fact, I would perhaps add to that that the making of a large commitment in bonds at the time of a new issue is in a sense giving a hostage to fortune, for you do commit yourself. You have to be pretty sure of your cash demand before you take that commitment.

COMMISSIONER BROWN: The reason for bringing the point up is that this is the sort of problem that the Bank of Canada did discuss, and it was in this context that if all the banks moved in unison and in this way with their deposits going up, and because it was involving a bond issue which had just been issued, the Bank of Canada was to a degree inhibited in their desire to start squeezing right away. But your contention is that this is a theoretical problem and does not exist.

MR. HACKETT: I think it is by and large a conceptual problem rather than an actual problem. The same problem arises, of course, in any situation and I think it is more apt to arise in the case of strong loan demands when there is a surge upward, and then the Bank of Canada is faced with the same problem, that whatever action they take is bound to have some effect on short-term money rates and therefore on bond prices. I think this is a general problem rather than one that can be isolated right in this area.

COMMISSIONER BROWN: I do not think the Bank of Canada possibly has quite the same inhibition about starting to squeeze out cash if it has not been in connection with its own operations of selling bond issues.

MR. CASE: May I suggest that it is not always the banks who do this. Sometimes your investment dealer customers can cause you to be in the same position. Then they come to you for loans, and the effect is the same.

COMMISSIONER BROWN: Have you any comments, Mr. Avison?

MR. AVISON: I was just thinking, Mr. Brown, that the case we are discussing could be a special case because, going on Mr. Hackett's assumption, that the banks clearly have some idea how they are going to pay off commitments that they have incurred, to the extent we change our other assets then the deposits of other people are being reduced and this is off-set by the increase in the Receiver General's account so that the total deposit structure in the system can on the whole remain unchanged.

COMMISSIONER BROWN: Of course, if a bond issue is bought by the market as such, then there are off-setting actions in your deposits.

MR. AVISON: I was going one step further and assuming that, let us say, the new issue was not necessarily attractive to all segments of the public but it was to the banks, we might

[illegible] which the

Bank of Canada probably [illegible] about starting [illegible] been in connection [illegible] operations [illegible] hand losses.

[illegible] that it is not always [illegible]. Sometimes your investment [illegible] in the same position. [illegible] to you for loans, and the [illegible].

[illegible] have you any comments [illegible]

MR. [illegible]. I was just thinking, Mr. [illegible], that the [illegible] be a special case [illegible] assumption, that the [illegible] have some idea how they are going to pay out [illegible] have incurred, [illegible] assets then the [illegible] of other people are being reduced and this is [illegible] by the increase in the Receiver General's [illegible] that the total deposits [illegible] the same [illegible]

[illegible] if a bond issue [illegible] there are [illegible].

MR. [illegible]

[illegible] issue [illegible].

adjust our portfolios to satisfy the requirements of the market and use these proceeds to pay for the new issue and the system does not change.

COMMISSIONER BROWN: There is no problem there?

MR. AVISON: I think we may be discussing a special case rather than a typical case.

MR. HACKETT: Perhaps there is one other point I might add, Mr. Brown, and it is from the standpoint of actual techniques involved. The Bank of Canada does have one avenue open to it whereby it can influence the cash base of the banking system without taking any market action, and that is the technique whereby balances may be shifted from the chartered banks to the Bank of Canada. In this case, there is no transaction in securities of any kind necessary, and therefore no action which in itself would drive down the price of any obligation.

COMMISSIONER BROWN: But it has the same effect, has it not, in that it starts to squeeze the banks?

MR. HACKETT: Except the impact is not on the market. The Bank of Canada is not in the market selling anything. The banks have to re-adjust their position. If they have made a bad judgment, so much the worse for the banks.

COMMISSIONER BROWN: Well, I think we can carry on now.

COMMISSIONER MACKINTOSH: May I interject one point here to clear my own mind. I hope I am not

just our portion [illegible]

[illegible] and [illegible]

in issue and the [illegible]

[illegible]

[illegible]

MR. ALLEN: [illegible]

clusive [illegible]

MR. SHAPIRO: [illegible]

other point I might [illegible]

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some [illegible]

[illegible]

[illegible]

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[illegible]

[illegible]

[illegible]

extending your thought unfairly. What I get out of this is that in so far as new bond issues are concerned you have led up really to the judgment that any conflicting considerations arise out of conflicts between the considerations of debt management and those of general monetary policy, you want to sell a big bond issue but you do not want to expand credit. In the more general case where you simply have a surge forward on the part of all the banks in loans or securities or what-not, the answer of the chartered banks is that the Bank of Canada has sufficiently current information about changes in deposits, but it can take action before you come to the day when the new reserve requirement applies. Is that a fair statement?

MR. HACKETT: That is, sir, in my opinion; it is indeed a fair statement.

COMMISSIONER MACKINTOSH: Thank you.

COMMISSIONER LEMAN: Mr. Chairman, if we might return now to the subject that Mr. Wadsworth had opened up just before recess, we have just gone through quite an analysis of what happens right in the banks in response to monetary policy changes, but as we all know that is not the end result of the exercise, and that a monetary policy can only have a useful effect if it affects things in what we call the real world, the spending plans.

Someone pointed out a few minutes ago that it is difficult to bring about quickly a major

change in lending policies by the banks. I wonder if that is really the only problem or the main problem, or is it also difficult to bring about changes that would be smooth, that would be small, perhaps, if what the monetary authority at the time wants is a small change? Is it difficult to obtain a degree of change that one wants?

MR. BOYLES: Mr. Chairman, perhaps I could endeavour to answer that question. There is a natural lag in bringing about appropriate response to such action inasmuch as, first of all, there is the matter of interpretation, the signals, and there is the matter of examination of lending policies. Indeed, the lending policies are of course matters for the consideration of the individual banks, but such policies are under review steadily in the light of our own forecasts, the demand for funds, the availability for funds, and so on, and once having made any alteration in existing policies these are quickly conveyed to the regional supervisors and to all branches of the banks. I might emphasize here that such changes are made on a uniform basis. We do not have a different policy for one area of the country as opposed to another. Naturally there is perhaps another delay. I think it is human in the minds of the managers, or it is human in those terms, that the managers are somewhat hesitant first in the thinking of the selfish motive that they do not like to see any reduction in the loans, and secondly they are indeed living in a community with their

change in lending policies [illegible]

if that is really [illegible]

problem, or is it [illegible]

changes that would be enough [illegible]

perhaps, if [illegible] monetary authority [illegible]

there is a small change? [illegible]

a degree of change [illegible]

MR. [illegible]: Mr. Chairman, [illegible] I could endeavour to [illegible] a natural lag [illegible] to such action [illegible] the matter of [illegible] is the matter of [illegible]. Indeed, the lending policies [illegible] for the [illegible] of the individual banks, [illegible] such policies are under review [illegible] light of our own [illegible] the availability [illegible] having made any [illegible] these are [illegible] and to all branches of the banks. [illegible] here that such changes [illegible] we do not have a [illegible] the country as [illegible] is perhaps another [illegible] the minds of [illegible] terms, that the [illegible] in the [illegible] not like to see any [illegible]

customers and therefore some time lag exists in respect to the conveying of the policies to such customers.

COMMISSIONER LEMAN: The submission would suggest that it practically needs a brain-washing to bring it about.

MR. BOYLES: There is another lag, too, perhaps, that inasmuch as you might decide to alter your lending policies, the banks have to take into consideration that to give effect to a change might indeed upset the balance of borrowing customers. They have their plans ahead, thinking in terms of seasonal buyings, and so on. In the main, while there is some lag, I suggest, sir, the lag is not really serious.

MR. NEAPOLE: May I just add something to that, Mr. Chairman? I think an awful lot depends on the timing of the instruction, so to speak. If we are in a normal liquidation period, which does exist around December or January, then of course it is relatively easy in a sense to regulate the increase that might occur. If their liquidation period was such, you could make, let us say, a small adjustment, or at least you would have more opportunity to do so. If, on the other hand, you tried to bring about something like this in June or July, when there is a big rise in demand for the fishing industry, the agricultural industry, and various other industries, then it would be more difficult, without question, to bring about a small or a precise control.

COMMISSIONER LEMAN: Well, as I understand the listing of the problems you have in your submission it would go in about this way; first of all, there is the natural orientation of branch managers towards wanting to make good loans all the time. There is the difficulty for head office to put out its own signals to the branches; as to how they should be worded, and as to how much the circular should describe the kind of pressure to which there should be a response. Then, you imply also that there is a problem related to lines of credit. You have described the system as one that has great flexibility, but this seems to imply there is a sort of rigidity connected with the existence of lines of credit. Can you describe for us to what extent lines of credit exist in our Canadian banking system, and how they work? What is their nature?

MR. BOYLES: They are really two types, and they are probably comparable. There is the type of line of credit which is the subject of a loan agreement. In other words, the client and the bank enter into an agreement and a line of credit is made available subject to certain terms and conditions. Such a line of credit, because it is a contractual agreement, is binding on the bank.

Then there is the other type of line of credit which is not the subject of agreement. It is the type of line of credit which is more common and which provides for, let us say, the seasonal requirements of the borrower. The banks regard this, perhaps, more in the way of a moral commitment subject, of course,

[illegible]

the listing of the [illegible] you [illegible] in your [illegible] it would [illegible], [illegible] is the actual [illegible] wants wanting to make [illegible]. There is the difficulty for [illegible] its own [illegible] of the borrower [illegible], and as to how much [illegible] would [illegible] the kind of pressure to [illegible]. [illegible] you imply also that [illegible] is a [illegible] related to lines of credit. You [illegible] described the [illegible] as one that has great flexibility, [illegible] this seems to imply [illegible] is a sort of [illegible] with the [illegible] of lines of credit. [illegible] lines of credit [illegible] banking system, and how they [illegible].

[illegible] There are really two types, [illegible] they [illegible] the type of line of credit which [illegible] agreement. In other words, [illegible] into [illegible] is made agreement [illegible] credit [illegible] subject to certain terms and conditions. Such a line of credit, [illegible] contractual agreement is [illegible].

The other [illegible] type of credit which is not [illegible] agreement. It is the type of line [illegible] the more common and which [illegible] the [illegible] requirement [illegible]

[illegible]

to changes in the financial position of the client,and also subject to the availability of funds. Normally such lines are regarded by the banks as commitments, and unless there are circumstances, such as those I have described, the customer is free to avail himself of those lines.

COMMISSIONER LEMAN: Can you give us any idea of the volume or size of what one would call firm lines of credit that exist in the system.

MR. BOYLES: We do have statistical data -- I do not have it here -- but in thinking of the two types I mentioned by far the line that is not subject to agreement is the one that is in existence. Does that answer your question?

COMMISSIONER LEMAN: It does partly. I noticed in paragraph 96 of the submission you say that the banks view their lines of credit with a real sense of responsibility, and then in paragraph 104 you explain that nevertheless these lines of credit are subject to review from time to time. Is this business of reviewing lines of credit something that is systematic, or is it a random type of process? Are they reviewed at certain times of the year, or are they reviewed all the time?

MR. BOYLES: Mr. Leman, generally it is a systematic procedure. We like to think in normal times that a line of credit is for a period of one year -- that is, in respect of customers who are in reasonably good financial standing. Such review usually follows the receipt of the annual auditor's statement of the

company. There may be cases where, because of, let us say, unfavourable conditions, the review of a line is much more frequent and, indeed, perhaps there may be a demand for more frequent statements.

COMMISSIONER LEMAN: But suppose the monetary authority does send a fairly clear signal, or, at least, there is a certain action by the Bank of Canada that you interpret as a signal, and you decide to send instructions off to your branch managers. Is one of the first steps to say to them: "Please review all lines of credit"?

MR. BOYLES: Yes, and in reviewing lines of credit that review would be subject to the nature of the business of the customer, and his forecasts or projections and plans, generally. As I mentioned earlier we would be rather loath to cut off or reduce a line of credit in respect of a customer who has already a clear-cut seasonal program in respect of his business. At other times, we may seek the cooperation of the customer in order to meet a tight money situation.

COMMISSIONER LEMAN: Is "Please review all lines of credit" equivalent to "Please discuss with all customers lines of credit"?

MR. BOYLES: Not usually. The instructions are usually more specific -- that is, as related to accounts. Here we may very well find that a client, due to a certain type of business, is in a position of being able to cooperate with us at that point -- that is, at the peak, let us say, of a tight money situation -- whereas, as I mentioned before, you might find another

client who might be a lumber operator and this might be at the very peak of his business, and in respect of whom it would not be sensible to request a cut-back in his borrowings.

COMMISSIONER LEMAN: Does a client know when the bank has reviewed his line of credit, and has increased or reduced it, or do you wait until he asks a question about it to tell him?

MR. BOYLES: The lines are usually established in response to an application from the customer. In other words, he projects his needs and tells us what his requirements will be, and that he would like to have a line of credit established accordingly.

COMMISSIONER LEMAN: You said that some of these lines of credit were quite informal. Did I understand you to say that they were often just an oral understanding with the customer that he can call on the bank for so much?

MR. BOYLES: Yes, very often they are oral.

COMMISSIONER LEMAN: So in the case of such a line you do not necessarily, because you have reviewed that line, call the customer in and tell him it has been reviewed down to 75 per cent of what it was before?

MR. BOYLES: Naturally, in considering his application you give consideration to all the factors. In one case you might have to satisfy yourself that he is asking for a line of credit that appears to be in the keeping with his requirements. In other words, if his application appears to be for an excessive amount you point out to him that he should consider a revision

downwards.

COMMISSIONER LEMAN: What I am not clear on, Mr.Boyles, is this, if as a result of tight money conditions you proceed to review lines of credit that are not of the agreement type do you automatically pass on to your clients the result of this review, or do you wait until they come in to make a borrowing?

MR. BOYLES: No, in cases where we feel there is justification for asking the customer's cooperation we call him in and seek such cooperation. In other words, we ask him -- although, I think this is a most infrequent occasion -- to cut-back his loans in such cases. I am thinking in terms of a regular operating line of credit. During periods of tight money there seems to be at some times an inclination among customers to avail themselves of the line of credit whereas, perhaps, under normal conditions they would not do so. In such cases we seek the customer's cooperation in holding back.

MR. NEAPOLE: May I interject something here, Mr. Chairman? I know we all have slightly different approaches to this thing. First of all, as far as we are concerned, we regard these lines of credit as guidance lines. Initially, they help us materially in the handling of an account because we are not constantly referring to the directors and the supervisors, and so forth, for permission or authority to go up to certain figures.

When instructions go down to the branches in cases such as this they have to go, first of all,

to the supervisors and the regional heads, and all the rest of it. I can say quite frankly that unless it is absolutely essential we do not start by referring to the smaller accounts. More control can be exercised through the big accounts simply because we are there dealing with people with knowledgability, careful cash flow calculations, and access to other markets for money. Right away our supervisors instruct the managers -- or they do it themselves in some cases -- to call in these customers, or go and see them, and say, "Now, this is what your cash flow shows. You said you were going to build an addition to your plant and that you would need so much money. Can that be postponed?"; or if the addition to the plant has already been built they might say, "Can you get the money from a mortgage source?". There are many, many things that enter into this, and it becomes a very close relationship on this particular subject.

However, the customer definitely has his warning, so to speak, and we enlist his cooperation.

The other extremity, where there is no cooperation, is a case such as we had at one time where the customer used his line of credit right away to buy up treasury bills as soon as he thought there was going to be some sort of a squeeze. But, by and large, our customers have cooperated awfully well.

COMMISSIONER LEMAN: But if an initial action by the Bank of Canada has not yet pervaded through the system and affected the thinking of the spenders, and they are not very conscious that anything has happened

[illegible] are the [illegible], and all the rest of it. [illegible] Unless it is absolutely essential [illegible] referring to [illegible] can be expressed. through [illegible] flow dealing with people [illegible] cash flow calculation [illegible] the more Right [illegible] the budgets -- or they do it [illegible] category, or [illegible] is what your [illegible] flow shows. You said you were going to build an addition to your plant and that you will need so much money. Can that be postponed?, or if the addition to the [illegible] could they say, "Can you get the money from a mortgage company?" There are many, many things [illegible] into this, and it becomes a very [illegible] on this particular subject.

However, the [illegible] has [illegible] warning, so to speak, and [illegible] cooperation.

The [illegible], is [illegible] cooperation, is [illegible] the customer [illegible] right away to lay on occupancy [illegible] was going to be some [illegible]

[illegible]

[illegible]

yet -- when monetary policy of the restrictive type has been in effect for quite some time perhaps everybody in the country is quite conscious of it, but I am trying to determine how long it takes after it starts to get through the whole system so that people are conscious of the monetary policy and its intention. I take paragraph 98(ii) as an indication that the key factor is the lines of credit. You say:

> "Adjustments in bank lending policies, apart from interest-rate changes, take effect primarily through alterations in lines of credit, and thus take some time to have their full effect."

I am wondering if at a time when there is a change to a certain direction the very first procedure through the chartered bank system is to review lines of credit and pass on the signal, as the banks understand the signal, to their spending clients.

MR. NEAPOLE: That is correct.

MR. BOYLES: Yes.

MR. NEAPOLE: And it can be done very quickly, too.

COMMISSIONER LEMAN: Therefore, to me that would imply that even clients who do not walk into the bank to exercise their lines of credit and apply for a loan are, nevertheless, notified if the line of credit has been changed?

MR. NEAPOLE: Yes, that is right.

COMMISSIONER LEMAN: Even if it is not the formal agreement type of line of credit?

[illegible] policy [illegible] [illegible] it, and

in effort [illegible] everybody in

the country is [illegible] and I am trying

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the [illegible] as to [illegible] lines of credit

and [illegible] on the [illegible]

[illegible] to their [illegible] offered.

MR. MARTIN: That is correct.

[illegible], Sir.

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[illegible]

would [illegible]

[illegible]

[illegible]

has been [illegible]

[illegible]

[illegible]

MR. NEAPOLE: Yes. I should mention, too, that in many cases we have lines of credit outstanding which are rarely used. Sometimes they are not used for two or three years. Nevertheless, they are reviewed from time to time with respect to the question of relationship as between cost and need. We review those, and we ask the customer: "Do you expect to use this? What does your cash flow show?"

MR. MULHOLLAND: May I make a further comment there? This is one of the most difficult operations for head office management in the initial stages of a monetary policy because it is very difficult to interpret the extent and the length of it. A time lag comes into play at that moment.

There are in excess of 5,000 bank managers in all the banks spread across the country. Through their training and experience they are highly competitive and aggressive men, and it is not easy to just turn off the tap overnight, so to speak, and have them become cautious managers who are willing to turn aside good loans that come within their own discretionary limits.

With over 5,000 branches in the system one loan for $1,000 is equivalent of $5 million a day. In a week, if that average pertained, you could have a total of $25 million, or $125 million in a month, coming on to the books of the banks and which you have not been able to get at because these managers have been acting according to the dictates of their own discretion, as Mr. Boyes has said. Mr. Neapole's comments that the first people you approach, and very quickly, are the

[illegible]

[illegible] [illegible], for

[illegible] certificates

which are [illegible] [illegible] not long

for [illegible] [illegible] [illegible] periods

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relationship [illegible] [illegible] [illegible] review those,

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What does your cash flow [illegible]

[illegible] [illegible] [illegible] [illegible] comment;

[illegible] [illegible] [illegible] [illegible] operations for

head office management in the [illegible] stages of a monetary

policy because [illegible] [illegible] to interpret the

extent [illegible] [illegible] [illegible] coming into

play at that moment.

[illegible] [illegible] [illegible] of [illegible],000 bank [illegible]

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their [illegible] and experience [illegible] highly conservative

and [illegible] [illegible] [illegible] [illegible]

off [illegible] [illegible] [illegible] [illegible] become

[illegible] [illegible] [illegible] [illegible]

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[illegible] [illegible] [illegible] [illegible] system on

loan for [illegible] [illegible] 5 million a day. It

[illegible] [illegible] [illegible] [illegible] could [illegible]

total of [illegible] [illegible] [illegible] [illegible] more, [illegible]

on to the [illegible] [illegible] [illegible] [illegible] not [illegible]

able to get [illegible] [illegible] [illegible] [illegible] [illegible]

[illegible] [illegible] [illegible] [illegible] [illegible], as

[illegible] [illegible] [illegible] [illegible] [illegible] the

corporations with the large lines of credit.

COMMISSIONER LEMAN: Your submission also makes clear that you do not believe that this process affects particular regions of the country, or any very clearly defined sector of the spending public. Has it truly a random effect?

MR. BOYLES: First of all, as I mentioned earlier, Mr. Leman, the instructions respecting policy are uniform throughout the system. There is no variation. In fact, we regard the lines of credit outstanding in a tight money situation in the same way in Vancouver as we regard them in Halifax. In other words, there is no variation in thinking in our efforts to, perhaps, hold back or to get borrowings reduced.

COMMISSIONER LEMAN: But from what you have just just said I thought one could, perhaps, infer that the effect may be quicker on large lines and large borrowers than on the small borrowers.

MR. BOYLES: Yes, it is.

COMMISSIONER LEMAN: Then to that extent it does affect one more than another?

MR. BOYLES: Yes, if you think in terms of numbers and types.

MR. NEAPOLE: In many respects -- again, I am interjecting -- many of the larger ones are more easily adjustable because they are able to get money elsewhere, or to make arrangements of some kind.

So far as our own bank is concerned, we establish degrees of priority, so to speak, and in that respect, to answer your question, a change in monetary

policy will affect some lines more than others, because there are lines that we regard as extremely seasonal and others as non-seasonal, and it is not hard to build up categories in that regard.

As I said before, where you have any seasonal requirements such as in the canning of vegetables and fish, and other perishable products, then you have to give those industries a very high degree of priority. You can tell that story to the branches easily enough if you try, and the manager, within his discretionary limits, can apply these principles of priority.

So, I think, insofar as our own bank is concerned -- and I would hate to think that we can pull out of business faster than others -- our instructions can be made broadly effective very quickly.

COMMISSIONER LEMAN: Only if what you desire is a very pronounced change in making policy. How subtle can you be? That is the question.

MR. NEAPOLE: As Mr. Mulholland said, when there is a great number of branches and so forth the sudden termination of a particular category might have a fairly broad effect fairly soon, so your answer is that it is difficult to be really subtle.

MR. WADSWORTH: I would think, if I might add this, Mr. Leman, that the first stage -- I gather that is what you are getting at; a modest change when there is no drastic action needed ---

COMMISSIONER LEMAN: I am trying to get at the real line. That is the problem.

MR. WADSWORTH: The first change can be made

by endeavouring to change attitudes to a degree in the way lines of credit are handled at the supervisory level, and the extent to which you will go on extensions, and whether they are for speculative purposes or not. I would suggest that most branch managers -- I agree entirely with Mr. Mulholland -- consider that their job is to go out and make good loans, but they are responsive to the type of applications they get. I think the periods we have gone through in 1959, 1960 and 1962 have made them even more receptive to little indications of changed attitude. I would think that would be the first stage of getting into these reviews which are reviews with the customer.

COMMISSIONER LEMAN: These experiences have been highly educational? Is there a way in which the bank's head office, also by the process of education, might develop a way of measuring the performance of managers in responding to head office instructions in this field?

MR. BOYLES: Yes, Mr. Leman. Usually when we send out instructions -- I am talking from the point of view of a particular bank, by the way -- we also ask them to report on the results of their actions taken in response to such instructions. In other words, we attempt to follow through, and not just be satisfied with issuing instructions and letting it go. We do, indeed, have a follow-up system, and do take appropriate action when we find nothing is being done.

MR. PATON: If I might interject something here, I think possibly branch managers are not the only ones who have improved their education. With recent experiences behind us the banks are perhaps better prepared -- a little more elastic -- with respect to monetary policy adjustments and therefore, depending on the severity of trend, there may be a time lapse before head office feels it essential to send out instructions to its branches. This would depend on their individual positions at the time.

To go back to the lines of credit, I have a little stronger feeling, I think, than Mr. Boyles indicates, perhaps in the public sense of the morality of the bank. I think that the bank has a little more than a moral obligation in this respect. It is a real obligation, and though perhaps in the ordinary line it is not a legal obligation, nevertheless I think by and large your average customer in this country would take a somewhat dim view if we repeatedly requested this line of credit adjusted downwards. These lines are not arbitrarily set by the bank, but after careful discussion with the customer and having regard to his prospects for the year. I think we like to think of ourselves essentially as "statement bankers" first, which is why we examine the statements carefully with the customers annually. We set the line which might well be put each year, and if at all possible we intend to stay with that line, and in that respect keep ourselves in the position where we can perhaps look after minor

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ordinary [illegible] legal obligation, nevertheless I think [illegible] encourage [illegible]

country must [illegible]

[illegible]

These lines [illegible]

[illegible]

adjustments in monetary policy and say that the time lag to which you referred -- I don't think -- is altogether in the best interest of the country by any means. We think we should be in the position of cushioning the initial effect of this before giving it to our branches.

COMMISSIONER MACKINTOSH: May I interject a question here without raising the interesting question of which obligation of the banks is higher. It is a moral obligation, and I would like to go back to an earlier spot in the discussion in which I understood it to be said that it was easier and more practical to force some contraction in the loan demand of the large customers than of the small customers.

Now, does this mean that the large customers can and will, in fact, adjust or contract their expenditure programs, or does it mean merely that they have more financial alternatives through which they can avoid adjusting their expenditure program?

MR. BOYLES: Well, sir, in the first place we would like to emphasize that we endeavour to give preference -- let us call it -- to the needs of the smaller one because he does not have the financial resources, he is in a more rigid position generally with respect to his operations, but I say that our first attention is given to the borrowings of the large clients because they do have access to alternatives, they are in a better position to adjust themselves to meet such a situation.

COMMISSIONER MACKINTOSH: Well, I am not

questioning that, but we are interested in ultimate effects of expenditure, whether capital or otherwise, that the monetary policy may have. Now, I can imagine that if you curtail credit to a small customer, the chances are he jolly well has to curtail his expenditures because, as you say, he hasn't the financial alternatives, and I am just asking if you have any judgment as to whether the large customers, who have so many financial alternatives, could accept your curtailment of credit but not curtail their expenditures or change their spending program, or have you any judgment on that?

MR. BOYLES: I think that the answer to your question is yes.

COMMISSIONER LEMAN: That he has these alternatives and his spending programs are not so readily affected?

MR. BOYLES: Right.

MR. NEAPOLE: I have seen quite a few of these curtailed spending programs; everything that is done, and, of course, they find the money somewhere else.

COMMISSIONER MACKINTOSH: It achieves a financial effect, and if they do this you follow it through to the real effect.

MR. WADSWORTH: I think a lot would depend on the purpose and what the customer requires the funds for, and that would probably temper his degree of looking elsewhere; if he felt this was essential to his business, I think he would be more inclined to endeavour to arrange it elsewhere, or probably the bank would still go along with it. If it was more of a

questioning [illegible], but [illegible] the [illegible] effects of [illegible] that the monetary policy may have. [illegible] I can imagine that if you [illegible] a small country, the chances are [illegible] because, as you say, [illegible] the financial [illegible] lives, and I [illegible] whether the [illegible] al[illegible]

but not [illegible] spending program. [illegible]

MR. [illegible]: I think [illegible] answer to your question to you.

COMMISSIONER [illegible] three alternatives and [illegible] programs [illegible] result [illegible]

MR. [illegible]: [illegible]

MR. [illegible]: I [illegible] these curtailed spending programs [illegible]

[illegible]

COMMISSIONER [illegible] financial effect [illegible] through to the real [illegible]

MR. [illegible]: I [illegible] in the [illegible] and [illegible] looking [illegible] this question, I [illegible] endeavour to [illegible] it [illegible], or [illegible] the [illegible]

speculative nature, where he felt that any response outside would probably be somewhat the same as the response from the bank, I think he would be more inclined to cut his cloth accordingly and cut his requirements.

MR. NEAPOLE: And the interest rates would enter into it, too.

COMMISSIONER BROWN: The question I would like to ask here is whether in the initial stage like this when you get people to slow down a little bit do all the banks act at once?

MR. BOYLES: Generally speaking, yes; there may be a lag of a day or two, but altogether the answer is yes.

MR. WADSWORTH: I would disagree and say no, Mr. Brown, at that first stage.

MR. PATON: I think that was the point that I was endeavouring to make in my previous remarks; that we don't act initially because the impact is not the same on all of us.

MR. WADSWORTH: The types of commitments outstanding are different between banks, and their assessment of the situation is different and the relative cash position may be different.

COMMISSIONER BROWN: Well, my second question is do you move when you see a slight change, or do you move only when you are convinced there is a major change?

MR. MULHOLLAND: We only move when we definitely can detect a major change.

[illegible]

outside [illegible]

response [illegible]

[illegible]

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[illegible]

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[illegible]

[illegible]

[illegible]

[illegible]

COMMISSIONER BROWN: And there is a competition, I gather, to see who spots it first or who spots it last?

MR. MULHOLLAND: We want to be last out and first in.

MR. WADSWORTH: I wouldn't like to leave the impression from our point of view that we wait until the very last moment. I think it may vary between banks as such.

COMMISSIONER BROWN: Which bank does wait until the last moment?

MR. WADSWORTH: We take turns! No, I think it varies with the assessment of the individual bank. It could be the same twice and it could be another one the next. We are certainly subject to all these human errors of judgment.

MR. BOYLES: One of the things that affects the timing of these directives is, of course, the restrictive liquidity position of the banks. In other words, the bank that is least liquid may get out such directives in advance of those that are more liquid.

COMMISSIONER MACKINTOSH: May I declare here that you are talking about undertaking steps for the curtailment or restraint of loans; prior to this you would have adjusted your cash by security operations and the process would have started really further back, but it only gets into the loan category when proceeded with, is that a fair statement?

MR. HACKETT: The two may overlap, but the

adjustment is apt to take place first in the securities area.

COMMISSIONER MACKINTOSH: Yes, and then you say that we will not have enough securities or that the loss is too much and we will have to pull tighter on the loan end.

COMMISSIONER LEMAN: Gentlemen, you have said that these two experiences that happened in the 1950's, mainly 1956 and 1959, have been highly educational and that you presumably imply by that that the banks will have learned through this experience to respond somewhat more quickly and also perhaps in a more appropriate way than they did under these two circumstances. Did you try to analyze in that respect what did happen on those two occasions; what the lag was in terms of time and to what extent monetary policy missed the mark because of this lag problem?

MR. BOYLES: First of all, going perhaps to the first part of your question, as I understand it, we keep some kind of a record, we examine the experience of how quickly it has become effective and what the response was on these subsequent occasions. Is that a way of putting it?

COMMISSIONER LEMAN: Well, I am trying to get some information about what was the lag in 1956, what was the lag in 1959, and the circumstances were somewhat different; could you analyze for us if the two experiences were educational? Presumably the first one was. Was there a big difference in 1959 as compared to 19[illegible] with regard to the way the system responded or from the point

of view of bank lending policy?

MR. MULHOLLAND: If I may just make a comment here on how we are being educated. I was a manager in 1956 and I didn't know very much about what was happening. In 1959 the circumstances were entirely different to any tight money period that had been experienced before, I think that is fair to say -- and I stand to be corrected -- and my recollection was that it came on the banks in two stages; there was a tightening period, I think, in the month of May or June, and a relaxation in July or an indication of a relaxation in the month of July, and then a very severe tightening up in the month of August. There seemed to be a change of direction as we saw it. In 1962 the exercise was something of an entirely different order, which you know all about, and it was very precipitous and in one direction.

MR. WADSWORTH: If I may enlarge on that, I think it is fair to say -- and you used the word "education" -- you always cannot experience things like anybody else, and in looking back and seeing what has happened it suggests looking forward, as a good banker or a good businessman, but we have had probably a more clear indication in, say, 1959 -- whether it was in the form of formal announcements or informal discussions -- I think perhaps we could have responded more quickly than we did and I think the evidence of that is that while drastic action was necessary for other reasons, as we know, in 1962, there were much more clear indications and I think the banks responded very quickly

in relation to the other two periods.

COMMISSIONER LEMAN: Well, let us stick to 1956 and 1959 because, as you yourself pointed out, in 1962 there were other factors there which perhaps permitted a different type of approach by the monetary authorities, but is it possible that in 1956 and/or in 1959 the decision making from the monetary authorities down to the head offices of the banks and down to the managers, and then the process continuing, that there was a lag before spending on goods and services was affected, and that all this timing may have been such that, in fact, it may have missed the mark, it may have not been well timed from the point of view of the business cycle and it did as much harm in this respect as to what happened later as it did to help the conditions of 1956 as such, or 1959 as such?

MR. WADSWORTH: The degree to which it may have affected conditions later, I don't know how one would assess that accurately, but I do think, though, that if there had been a more clear indication a little earlier the change could have been brought about more gradually and with probably less effects at that time on individual borrowers and their requirements.

COMMISSIONER LEMAN: Well, you haven't tried to get a more precise view of what the lag is in terms of time. Earlier you referred to Lord Cobbold's remarks about making a guess at six months, but have you got a figure in mind as to what the lag has been?

MR. WADSWORTH: I think that was answered to quite a degree by Mr. Neapole, and I think the season

of the year or the time of the year -- if you follow the seasonal trend of bank borrowings, there are periods when they are going up and it is much harder to attract loans or hold loans in that period than in a period where we normally expect a greater degree of liquidation, so I think that has an affect, Mr. Leman, on how long.

COMMISSIONER LEMAN: I understand that at times,when the monetary authorities want a sharp and very pronounced response, besides just acting on cash, they will sometimes call the banks in and have a talk about the whole situation. How has this worked in practice? Is this the type of action by the Bank of Canada that produces very many useful results?

MR. BOYLES: Yes, Mr. Leman, because the outcome or the result of such discusions provides us with a clearer signal of what their thinking is and we are equipped to cooperate and to respond.

COMMISSIONER LEMAN: Well, some such action by the Bank of Canada wasn't just having a talk with you; I gather that -- well, the Governor himself told us that there is a process called moral suasion that enters into this procedure; how has this process worked in relation to the banks' responses, the chartered banks' responses?

MR. BOYLES: It has worked quite well. As I said earlier, this so-called moral suasion has indeed been considered by the banks and we have been quick to respond to these suggestions, let us call them.

MR. WADSWORTH: 1951 was an example of that. I think that was mentioned by the Governor

himself in his evidence.

MR. NEAPOLE: The most, shall I say, severe one was at the time from roughly the 1st of November, 1954 -- was it 1955 or 1954? -- on into the months that followed, that initially the Governor of the Bank suggested that we should have secondary reserves of 8 percent, in addition to 8 per cent, and that we achieve this by roughly three months.

We quarrelled right away about the three months feature as I recall the details -- I wasn't in the C.B.A. at that time -- and we said that it was impossible to achieve 8 per cent in three or four months and as a result of this discussion we ended up with a 7 per cent additional reserve and the date was described as by June, so I think it was sometime in June -- May 31, was it -- by the 1st of June, then, we had achieved this 7 per cent instead of the 8 per cent originally suggested, but that was a case of cooperation to our fullest extent and within what we knew we could do and that, of course, indicates a six months period.

My own belief is that -- from what I saw of 1956 and 1959, and so forth -- that it does take six months, that is a very good figure, before any real affect is felt. You could easily say that in 4½ months some affect is starting to be felt, but I think that six months is a good figure.

COMMISSIONER LEMAN: This is the real effect on spending on goods and services by bank clients?

MR. NEAPOLE: Yes, when it is starting to be felt.

COMMISSIONER LEMAN: This has been educational from the point of view of a case where you want a strong, restrictive effect on the economy. How educational has it been from the point of view of trying to have an expansionary effect on the economy?

MR. NEAPOLE: That is always extremely difficult to say. Perhaps more than the other, because when you come to an expansionary period you are then waiting for your customers to have confidence that they can embark on things. On the one hand you can review credit with a customer and say, "You have to cut back"; but, on the other hand, you do not run around to all your clients and say, "There is lots of money, come and get it". You have to wait for them to build up their own confidence, as to whether to take a chance and act. They get to know that money is easier because they are more knowledgeable now, and there are things in various newspapers, indices and reports; but they still have to have their own confidence restored -- if that is the right word.

COMMISSIONER LEMAN: You implied that what the Bank of Canada has done from time to time in giving you rather specific views as to what the

bank should do relative to secondary reserves, or stopping term loans, or that sort of thing, has worked well. Have they always been the type of instructions with which the banks agreed, or in which they were fully in agreement with the Bank?

MR. NEAPOLE: I can only speak for myself and the time I have been given these instructions, just the last couple of years. Certainly, I cannot say I have disagreed with the Governor. He has always presented the thing in a very lucid and reasonable way, and has a statistical group behind him to support all his views. I know I have always felt that I believed it and would co-operate; and, of course, it has been useful in that regard.

MR. MULHOLLAND: The views that Mr. Neapole has expressed are certainly the views of the Association.

MR. WADSWORTH: I think it has this one added feature, that it has permitted the banks -- and we do wish to co-operate in the national interest-- to prevent particular views as to certain effects of these policies and some indication of the problem involved, by having it on the basis of discussion such as you mentioned.

COMMISSIONER LEMAN: This suggests it is the Association's opinion that any time the monetary authority feels that what it is bringing about is a real change in monetary policy, it would be better if it did call the banks in and spell it out

clearly. That is your unanimous opinion?

MR. MULHOLLAND: The answer is, "Yes", Mr. Leman.

COMMISSIONER LEMAN: If I might go back a little, "up the line", in this lag problem, there is one thing I would like to understand a little more clearly from the point of view of the chartered banks themselves. When the monetary authority takes action, one of the first results is to get the banks to sell securities. This is usually an atmosphere in which the banks are likely to take losses on these securities, and sometimes progressively larger losses on these securities. I think Mr. Hackett explained this process.

MR. HACKETT: Yes, that is so.

COMMISSIONER LEMAN: What is it, in the reaction function of the chartered bank, that really causes it to change its own lending policy? Is it the losses it is taking on securities, or its own notion of what its liquidity position should be? What is the nature of the reaction?

MR. WADSWORTH: I would say it is the latter, Mr. Leman. I do not think banks have ever hesitated to take reasonable losses to meet what they considered sound loan requirements, subject to what a bank feels how far it should go as far as its liquidity position is concerned.

COMMISSIONER LEMAN: There is one paragraph here -- and I have not my finger on it at the moment -- where, I believe, you explained

that there was a different reaction between banks as to the way in which securities, as you call it, are run off. I got the implication from that, that an individual bank might not react necessarily like the other banks, and one might decide fairly early in the game to take a pill and begin to take losses early in the game on fairly long securities, and not act promptly on shorts. Another bank might feel a little confidence that this will not go as far as some other people think, and avoid losses on longs.

MR. WADSWORTH: I think that is quite a fair statement, and it is one of these areas of individual judgment, or judgment of top management of any one bank of the action it should take at any time, and their assessment of the situation. They will never be uniform -- or seldom, I would think.

MR. HACKETT: Perhaps I could add this, Mr. Leman, that the actual loss factor at the time will vary between banks, depending on the way they happen to have their portfolio arranged. But in addition to the loss factor there is also the fact that your portfolio is shrinking one way or another -- either by maturities or sales. At the same time in this process the fact that your portfolio is shrinking in total has some bearing on the attitude of mind you reach.

COMMISSIONER LEMAN: What is the real trigger?

MR. HACKETT: I would think the trigger varies between different banks, and I think it varies among the banks at different times in history. Right after the war, when bond portfolios were extremely high, I think the trigger point might be a good deal further on in the process than it would be under more recent conditions, when bond portfolios have not been extraordinarily high.

MR. NEAPOLE: Finally, you have to make a judgment.

MR. WADSWORTH: I think you could say that the converse takes place when banks are in a position to add to their portfolio. You will get differences of opinion between banks, and one might wish to forego a certain amount of income to maintain a little more flexibility, and another bank's assessment might be somewhat different in the situation, and it might be prepared to invest at a longer term with a higher yield.

COMMISSIONER LEMAN: Since this business of liquidating securities by the banks at such times is such an important step in the process, are there things about the market in Canada that the banks feel should be improved in order to facilitate this process, so far as they are concerned?

MR. HACKETT: Mr. Leman, looking at this from one point of view, it is, I think, a question of fact that the market has been broad enough and deep enough to permit the banks at times

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to dispose of rather massive amounts of securities -- speaking from memory, I think it was 1959, something like a billion dollars, or rather more, in one calendar year.

Now, at the same time our market in Canada for the type of securities which banks hold normally -- and which, therefore, they are likely to be selling or allowing to run off -- is not all that broad that you cannot do that without a considerable impact on the price of securities. The mere fact that the banks are in there as sellers, and they do generally tend to be at around the same time -- I do not mean the same day, but in the same period of months -- is bound to have an effect on market price levels -- not only because of the sheer weight of the transactions involved, but by reason of the reaction of the market itself to the knowledge that the banks are in there selling. Sometimes that is apt to put a multiplier on market expectations.

I think somewhat the same thing can be said, though perhaps not in such extreme form, when the reverse conditions maintain and the banks are able to add to their security holdings. Let me put it this way: the word soon gets around in the street that the banks are buying.

If I may make a personal observation here, sometimes my own experience has been that you are making an extremely modest purchase at one moment of time and you hear on the telephone, in

the sort of chit-chat that goes around the street, that you are in the market in a rather big way. The fact you are in the market is noted by the investment community.

To answer your question: I do not know that there is any technical thing that can be done to remove these fundamental disadvantages that the banks are a large factor in the securities market, both ways. I think we can hope for two things. One is that with the broadening of the market the banks may become a relatively smaller factor and that their own actions in it will not have as pronounced, shall we say, by-product effects as now occur. The second thing which we would hope is that over time it may be possible to initiate more gradual changes in monetary policy itself, with the result that these adjustments in securities portfolios the banks have to make might be spread out a little, over time, and the immediate impact of price levels would not be as great as it now is.

COMMISSIONER LEMAN: This would tend to make the banks less vulnerable to sudden and sharp price fluctuations.

MR. HACKETT: I was thinking of making the market less vulnerable also.

COMMISSIONER LEMAN: A few minutes ago Mr. Neapole told us he thought it might have taken, say, six months to get at the process of spending decisions through this particular sector

of bank lending policy. Were there other things that might have taken effect earlier, just due to the change in interest rates, long rates especially? Do you believe spending plans had been affected before the six months, just due to the change in the interest rates level?

MR. NEAPOLE: Due to interest rates entirely, do you mean?

COMMISSIONER LEMAN: Yes, because the Bank of Canada refers to the process as being one in which they change credit conditions, but the exact definition of what-all "credit conditions" is is not too clear. There is the general level of interest rates, and then there is this particular effect they want through the chartered banks, changing their lending policies -- not just to raise the rates to affect their relations with their clients.

DR. McLEOD: Mr. President and Mr. Chairman, I wonder if I might beg leave to intervene and make a comment as to how it looks from the bank economists' point of view? I did not want to interrupt the flow of questions, but this, I take it, is directed particularly to quite moderate adaptations in monetary policy, and not those that require a sledge-hammer technique to drive them home.

I would like to say, in observing operations from within, it seems to me head office responds to these much slighter changes, perhaps

without being aware of it, in a way that is really positively important. I think we are aware of some of the limitations on the monetary policy, but I think it is important to realize this does work in a delicate way too.

Perhaps economists have a certain prejudice for looking for infinitesimal adjustments at the margin, and I think this does occur. I think perhaps the way to explain it would be in terms of reaction to constant flow of loan applications that are coming into the banks. I hear bank managers saying they get their impression of what the actual state of the bank's attitude to lending is by observing what is happening to their flow of loan applications, and I think the alert branch manager and regional officer does follow this up, and I think it does have an important effect. Indeed, the management at head office always has its eye on market conditions -- whether it is the long market, the money market, or whatever. Surely this is what influences them. Perhaps they do not think of them affecting their loan decisions, but I think it ties in very much with a remark made to me in private conversation by a central banker -- whom I cannot therefore name because it was in private conversation -- that he felt the most effective way for the central bank to let its policy be known was through its open market operations, what it was actually doing in the market.

COMMISSIONER LEMAN: Well, you have all observed, I imagine, that in England, for instance, the spread of rates, from bank rate down, is much more automatic than it is here in Canada. There is practically a conditioned reflex that gets into the economy, based on the bank rate, and a lot of things are related to that in a very rigid way. We do not have quite the same phenomenon in Canada, and there is a little more flexibility in our system, and every rate in the country does not seem to react to the bank rate in the same way. Do you think it would be better to have a more automatic type of shift than the more flexible type of shift that we have here?

DR. McLEOD: Is that question addressed to me, Mr. Leman?

COMMISSIONER LEMAN: To any one who wants to field it.

DR. McLEOD: I think the feeling of the banks is that it is important to have flexibility in the rates structure and have rates move in some sort of relationship to one another. I think it is fair to point out that we feel that the prime rate should move with the general pattern, and to tie in any specific fashion to any particular rate would simply substitute new rigidities in the system for those rigidities we now have. We would rather see it in terms of a general flexibility, for the market to respond on its own terms.

MR. WADSWORTH: I will just add, if I might, Mr. Leman, that as you know until recently we had the so-called floating bank rate which was changed weekly, and I do not know that we have had a long enough period to determine whether changes in the fixed bank rate may reflect themselves more in other rates than in the rate that is varying from week to week.

COMMISSIONER LEMAN: We also had the 6 per cent ceiling on bank interest rates, but you do refer to this flexibility yourself. In paragraph 99 you say:

> "It should be remembered that the Canadian branch banking system has an important degree of built-in flexibility, because behind each branch stand the resources of a large nation-wide institution. The branch is not limited to its own resources, ..."

And so on. Can one infer from that that from the point of view of quick responses and effectiveness of monetary policy, an atomized system of small banks scattered around the country would give better responses than the type of system which we have, which is more concentrated into a few large units?

MR. WADSWORTH: That gets back to the flexibility I mentioned earlier in answer to Mr. Brown's question before the intermission. I do not know but that in some years it might give a quicker response to the central bank's action, but I think the effect on the economy as a whole or, let me put it the other way,

that the effect on the economy through a national banks system where funds do move from one area to another and big requirements in one area can be looked at regardless of the deposits in that area, is much better for the economy.

COMMISSIONER LEMAN: You are saying that the advantages of this type of system outweigh the disadvantages, but you agree this is a disadvantage?

MR. WADSWORTH: I think they would far outweigh the disadvantages.

COMMISSIONER LEMAN: There is one point I should like to come back to. Mr. Neapole made the bold case that perhaps six months was a good figure for the lag. Would you be prepared to go so far as to break down this lag for us into its different steps?

MR. NEAPOLE: I think that is a kind of, shall we say, estimate that would be made by a "seat-of-the-pants" flyer. It is the kind of judgment you just form. I could not break it down. You watch your loans from day to day and you watch categories and you see that some are coming down gradually, and so on and so forth. It is most difficult to give you anything that you could regard as a precise answer on that.

COMMISSIONER LEMAN: Well, Mr. Chairman, I am through with this section.

COMMISSIONER BROWN: I wonder if we could turn now to the question of debt management? You have quite a strong criticism of the Bank of Canada's operations before 1962 in connection with new issues. Perhaps you could outline for us, Mr. Hackett, how you would

operate the Bank of Canada's position in putting out new issues?

MR. MULHOLLAND: Could Mr. Avison answer your question?

COMMISSIONER BROWN: Mr. Hackett has passed the ball to Mr. Avison.

MR. AVISON: I think on that criticism to which you referred, Mr. Brown, as you will have reviewed, I am sure, the average cash figures for the Wednesdays before and after new issues have appeared, there were clearly not significant but sizeable changes in the cash position before and after the new issues.

I do not think we were attempting to do any more than to say this tends to have distorting effects in our attempt to estimate monetary policy, for we had very short run changes which were subsequently reversed. As the brief points out, up to 1960 one type of pattern was followed, and subsequent to 1960 a somewhat different pattern has been followed.

I might make the observation that this is in the context where the position of the banks as such had changed in relation to new issues. Some years ago it was the custom for the chartered banks to be given at the time of the new issue firm bonds for their own portfolio and then a much smaller amount of bonds which could be used to fill their clients' requirements or be used for trading purposes.

As you know, this policy has changed now and at any time of a new issue, when a bank is required to acquire that new issue, that bank is exact in the same

position as any other purchaser in the market place who wishes a new issue. I think the attempt we had in mind was not necessarily to change the technique of new issues per se but rather we would hope this could be done without the swings in cash prior to and subsequent to the date of a new issue.

COMMISSIONER BROWN: Would you prefer that a neutral policy be maintained at the time of a new issue?

MR. AVISON: Consistent with whatever the basic monetary policy is of the authorities at that time, yes, sir.

COMMISSIONER BROWN: A little further on you make the point that:

> "We believe that the federal debt should continue to be managed by the Department of Finance, using the Bank of Canada in an advisory capacity only. We would not be in favour of setting up an independent body to make debt management decisions. Debt management techniques, however, would probably be improved if either the Department of Finance or the Bank of Canada were to consult banks, investment dealers, and institutional buyers on a regular basis as is done in the United States."

Now, is there an implied suggestion here that this should be a formal body of some kind?

MR. AVISON: I do not like to use the word formal because that might tend to make the proceedings

too rigid, but I think what we had in mind was that from time to time we felt it might be desirable if representative groups -- and I am satisfied that these groups would conduct themselves so they would not gain any advantage over other people in the same industry who are not included in that group -- that from time to time these groups might be consulted because they might have certain patterns they would be interested in that they could convey to the authorities not so much on a formal basis but on, let us say, an ad hoc basis.

COMMISSIONER BROWN: Is it thought this should be on a regular basis and not necessarily in the context of a new issue?

MR. AVISON: No, we were thinking of it, Mr. Brown, in the context of a new issue, obviously not every new issue because they are coming with such frequency, but these are interested bodies which might very well assist in the thinking that would be directed to the new issues. Obviously there is no thought in our minds at all that any of these groups would receive prior knowledge as to what the official position would be. That is not our intention. It is purely to provide an interchange of information and ideas.

COMMISSIONER BROWN: Thank you.

THE CHAIRMAN: We shall adjourn until 2 o'clock.

--- Adjourned.

--- The hearing was resumed at 2 o'clock.

THE CHAIRMAN: We shall now resume.

COMMISSIONER GIBSON: Mr. Chairman, if I might go back to the responses to changes in the cash position of the banks, it would be very helpful to the Commission if some of the bankers could go through the chain of responses of what a bank does when it loses cash, and this situation persists for a few days, and when it moves from the process of adjustment through treasury bills and day loans to selling securities, and when it begins with a continued cash problem in terms of tightening up a lending policy.

Obviously, a lending policy is not tightened and eased too frequently, and if you can give us a little more impression of your initial response to a persisting loss of cash and how that fans out and when it ultimately begins to affect the monetary policy, this would be most useful.

MR. HACKETT: Perhaps I might start with this, Mr. Gibson, and I think there will be an appropriate stage when one of the other general managers might pick it up. My partial response is going to be rather in the technical area. I think the first problem that arises in a loss of cash is one's assessment as to whether what is going on is the result of some maldistribution of cash in the system, something that will adjust itself in a relatively short time, or whether the fact that Bank "A" is losing cash is a counterpart of what is going on more or less simultaneously in other banks.

That is the question which is usually fairly easy to answer within a few days. The weekly statistics turn up and you can see what your position is vis-a-vis the others. The immediate response -- and at this stage I am assuming that one does not know precisely what kind of situation one is faced with -- but the immediate response is probably to do the thing that is easiest to do and that costs you least, which might be to call day-to-day loans from the market or, failing that, to go up the next rung of the ladder, assuming you do what you can do there, and either endeavour to sell treasury bills or, what is more common when they run in at the tender, let more run in than you are bidding for.

If that process goes on for any significant length of time, obviously Bank "A's" liquidity ratio will begin to shrink. A tendency for your liquid ratio to show a persistent shrinkage is something which at that time you are paying attention to and beginning mentally to assess the implications of if it goes much further.

You are still faced with the problem of knowing how long this is likely to last, and what are the reasons for it. Signals by this time are beginning to crop up. There may be and probably will be a significant change in the treasury bill rate and in day-to-day money rates. After a couple of weeks, or perhaps sooner, there will be a response in very short-term market rates which tends to fan out and move up the ladder of maturity, the longer this tendency towards

stringency persists.

Before that time it is not only the official of the bank concerned with cash management that is aware of these things. He has undoubtedly brought these trends to the attention of the general manager and other senior colleagues in the bank, and the thing is pretty readily known. Should the process go further, then you have to add something by way of sale of securities or perhaps you change your attitude to a maturing obligation: Will you renew it or will you let it run in?

I should like to make this point, however, that before you get there you are already, shall we say, put on notice that a change in the direction of monetary policy is not only in the offing but is probably with you, and that certain adjustments in lending policy may be necessary.

I think, Mr. Gibson, it might be proper for me to stop at this point, hoping that someone else will pick it up from the standpoint of what is going on in the lending area.

COMMISSIONER GIBSON: Yes. If you could elaborate now on the degree to which securities have to be sold before action is taken in terms of lending policy, before any serious action is taken, this would be very helpful. What we are endeavouring to get is a sort of picture of the trend of action up to the point where you really get restriction in lending.

MR. HACKETT: Perhaps I might add -- and this may not be any addition to what I have said --

that basically what you are up against is an assessment of the nature and duration of this shift in monetary policy. This may sound a little circuitous but I think it is true. The immediate action you take with respect to selling securities may be governed by your assessment of what you may have to do later. Considerations such as this come to mind: Is your first loss likely to be your least loss? Is it possible that by delaying action one may be postponing action that will have to be somewhat of a greater magnitude just because it was postponed? There is not a formula for this, Mr. Gibson. These are the sort of considerations, as you well know, that arise.

COMMISSIONER BROWN: Is somebody else going to take the ball?

MR. NEAPOLE: I have nothing to add to that except to say that it is a daily study and that many, many factors enter into this problem. This depends, of course, on where you start as far as your cash and secondary reserves are concerned and all the rest of it, and how your averages are working out, and so forth. But it is a daily consideration not only by the people who have to make these appraisals from a mechanical standpoint, but the judgment that they bring to the general manager and then the decisions which have to be made. It is a daily study.

MR. BOYLES: The matter of the liquidity ratios must have an important bearing on the extent to which you are ready to dispose of your investment portfolios before embarking on the next step.

MR. WADSWORTH: All I can say in enlargement on that, Mr. Gibson, in the same line with respect to the composition and extent of your portfolio -- and I think you give some weight to that -- is that I think the first reaction, as you mentioned this morning, would probably be from the senior or general management levels and would be somewhat of a change of attitude towards a growing increase in the total of loans and the type of loans that were increasing.

Probably the first action would be taken in that general area of loans that were, as we mentioned, not of an essential nature but more of a speculative nature. I think also that the attitude the bank was taking would become gradually known down through the organization.

If that did not work then we would go on through the stages that were also mentioned, the stage of going through the various lines of credit with the customers and identifying those areas where probably, if not a reduction then a curtailment could take place. This is all subject to reserves going down, or the loan total going up.

COMMISSIONER BROWN: You say this is known throughout the organization, but how is it made known? Is this done by memoranda, or by a telephone call to the supervisors, or how?

MR. WADSWORTH: I would think, in the first instance -- this would vary probably as between banks, but I am thinking of the stage where you do not want to send something out and change the attitude completely of five or six thousand branch managers. There is a continuous flow back and forth from the managers to the regional superintendents, depending upon the organization of the bank. There is also a flow of information in formal conversations regarding credit matters and various accounts and various types of accounts. Whether it is an attitude of expansion, or an attitude of holding the line, or an attitude of showing a bit of caution, or an attitude of contraction,

it becomes known through the exchange of correspondence that that is going on daily throughout the bank. I am speaking now of the early stages.

COMMISSIONER GIBSON: But you do not take much action in the lending area until your liquidity position has begun to approach a point where you think, if it continues, it will soon arrive at a point where you would not wish to see it go much further? You more or less said that this morning, and I wonder if you would elaborate upon it.

MR. WADSWORTH: I shall be glad to do that if I have not already gone far enough. Yes, you would be watching your liquidity ratios throughout the piece. I think you would also be watching -- and here it would depend not on what was causing this but on what was the apparent stage of this period you are going through -- to see just where loans were going steadily up. You would watch not only your liquidity ratio but you would look to see if it is increasing in total, or whether it has started to level out a bit, and you would base your thinking upon forecasts of where there are heavy pay-offs coming in. All those things, I think, would have an effect on what you do in the next step. If the loan total was going up more rapidly then you would take more direct action at a much earlier date.

COMMISSIONER MACKINTOSH: Mr. Chairman, I would like to turn to one other area briefly. We have had many representations and suggestions to the effect that, generally speaking, the markets should be improved

and allowed to have their effects; that restrictions and rigidities in the market ought to be removed whereever it is possible to do that, and that on the whole central bank action ought to pass through the markets and not to any degree that is avoidable act through direct controls of any kind. With that background I would like to look at the paragraphs in your brief that deal with competition among the banks. I am referring to paragraph 360 and on.

In one of the early paragraphs you point out that because all the services the banks offer are pretty uniform from bank to bank the rates must necessarily be uniform, and that competition has to take a different form. I wonder if we could start out by having someone indicate what other forms this competition takes. You have already said the services are pretty standard.

MR. WADSWORTH: I would think, Dr. Mackintosh, that it takes various forms. I would like to make a brief reference before I go further to this point — you mentioned uniformity of rates, but even within that there is competition because the bank offering the best price is the one that often sets the pace. There is a competitive factor in that area.

In other forms it could be in the lending field. There are always new plans of lending that might attract business in other ways. While all banks are in the consumer and personal loan field there is a difference of timing as between various banks coming into it. There is the branch representation, and the services that the branches provide. We referred to

personal chequing accounts yesterday, and they are somewhat uniform but there is a somewhat different basis of merchandising them as between the banks.

Every bank, of course, tries to have the best trained personnel, and the best equipped personnel, but the degree of success in that regard, I think, is another competitive factor.

There may be other areas that other general managers would like to mention. There is the very important area, of course, of business development. All banks have a business development department or an economic development department, which works with the managers and in conjunction with the managers strenuously at all times to attract business, and not only business that is already in the country but new business coming in. That is reflected in foreign representation as well.

COMMISSIONER MACKINTOSH: What about the addition and location of branches?

MR. PATON: In connection with that is your question: Does it have any effect on the progress being made by an individual bank vis-a-vis the others?

COMMISSIONER MACKINTOSH: Yes, or to put it in another way, what sort of guide lines do banks follow in planning the addition and location of branches?

MR. PATON: I think possibly in answering that I might say that historically the chartered banks in Canada have sought out the needs for banking rather than having the need seek out the banks. We have followed the economic development of Canada as it has

developed over the years. As we all know, in the early days we followed the railroad to many places, and we continued to locate in such places. These were newly formed and newly developed areas.

We are governed, of course, by the fact that we hope to have a profitable unit of the bank in such a place. That is the main feature. Competition is very keen in respect to reaching these places first. Our judgment is not always infallible by any means, and at certain times in our history there have been occasions when we were probably a little too eager to expand our branch representations. We quickly found that out when we looked at the profit and loss sheets over the years.

By and large, our basic philosophy in expanding our branch representation is for each bank to give a better service to its customers, to attract more customers and, in general, to be more all-embracing insofar as banking services are concerned.

COMMISSIONER MACKINTOSH: I cannot refer to the indications specifically, but I recall certain indications that there may be a considerable period of time elapse before a new branch can show a profit. This must be pretty costly to the banks, and there is some question as to whether or not it is costly to the country. There has been the question raised as to whether we are not over-banked, and as to whether competition in this field has not led to too many branches. Is there any way in which this can be avoided. Are all the banks competitively rushing into

this, unable to stop themselves?

MR. PATON: I think that to put any rigidity into the competition as between banks would be more detrimental than the risk of excessive representation in any individual spot. I think it should be noted, perhaps, that with very minor exceptions the charges for, and the availability of, the banks' services are not excessively weighted if a branch location is somewhat out of the way. There are differences, perhaps, as between the charges in metropolitan Toronto and a branch up in Yellowknife, or some such place, but basically the services given are the same.

COMMISSIONER MACKINTOSH: I would not think the chief concern was whether there was a branch in Yellowknife or Pine Point. These are praiseworthy pioneering efforts. I would think the multiplication of branches in suburban areas of large cities is involved in this question. In those cases there may be a lot of effort, but it is not particularly colourful pioneering work.

MR. PATON: In general, our basic philosophy in opening branches is that we want to put them on a paying basis within three to five years. That yardstick is effective in the urban areas, and in the main city areas as well. We do not always achieve that, but on the average it is fairly close.

COMMISSIONER MACKINTOSH: What is the action likely to be if at the end of a period of five years the branch is still not paying?

MR. PATON: Well, we examine the reasons

to try to see why it has not been as successful as we anticipated. There may be many reasons. Perhaps the particular location has not developed as anticipated. Perhaps industry has not reached that point, and which we expected it would when we first went in. Perhaps our representation in the form of management has not been exactly suitable to the location. If that is so we will replace the manager and give it another whirl to see if that was the main contributing factor. I think it is fair to say that where there are repeated losses with no indication of the trend being reversed we will then take remedial steps by possibly closing out the branch concerned.

COMMISSIONER MACKINTOSH: That is a fairly rare occurrence, is it not? It is a rare thing to find a bank backing out altogether?

MR. PATON: I would say, generally speaking, that it is not too common.

MR. MULHOLLAND: I think it has been generally the experience, if I may add to that, Dr. Mackintosh, that in many cases -- perhaps in most cases, and certainly in the cities -- if an opportunity to open a branch occurs in what is obviously a potential field to the bank for a profitable unit, or the opportunity occurs to open a branch, for instance, in a major office building or a commercial building, then advantage is taken of that opportunity. If that opportunity is passed up by one bank then I am quite safe in saying that at least one other bank would soon assess it as being a profitable unit for the future and would not

hesitate to take the place of the bank that was hesitant in going in.

COMMISSIONER MACKINTOSH: Yes, I am quite clear that competition, or potential competition, forces the pace here. The question is whether it forces it too far and too fast.

MR. MACARTHUR: I have some figures here, and it is interesting to note this comparison of branches versus population. In 1955 there 4,246 branches including sub-agencies in Canada, and the population per bank at that time was 3,697. In October of 1962 there were 5,312 branches and sub-agencies, and the population per bank was 3,496. The number of bank branches has remained fairly static with reference to the growth in population. The rise in population has caused a similar rise to occur in the number of branches.

MR. LOUIS HEBERT: Perhaps at this time you would like to have the opinion of -- I shall not say a small bank -- a bank that is smaller than the others.

COMMISSIONER MACKINTOSH: A small but important bank.

MR. LOUIS HEBERT: Yes. In speaking before Mr. Leman I should mention that I remember that Mr. Leman's father was my first general manager, and when I became many years ago the chief accountant of my bank he was also my first president, and I pay tribute to him.

COMMISSIONER LEMAN: Thank you, Mr. Hebert.

MR. LOUIS HEBERT: We are glad that generally

bank interest rates on deposits and on loans are closely uniform. It facilitates the operations, and the competition we have received from other banks has certainly been fair.

Perhaps in Quebec we face more competition than the others from the near-banks. Their representatives have told you that the chartered banks should be closely controlled, and that our maximum rate should be fixed. For themselves I suppose they say that they can control themselves very well. Many years ago it was the same. It was Mr. Leman's father who said that the caisses populaires were in a way the complement of banks, and now they are 15 times more important than they were at that time. We hope that the near-banks will become subject to the same regulations that we are subject to. They are doing banking business. Perhaps in the future the "banques populaires" will be applying for membership in the Canadian Bankers' Association.

It is my hope that this will encourage them to give the same services that we are giving now. When that happens everybody will be happy because they will be subject to the same regulations and to the same cash reserves as we are, and they will have, no doubt, the privilege that they mention we have of lending 12½ times the amount of deposits. I cannot understand this -- perhaps because I am not an economist -- but perhaps it means that when we lose deposits we are losing 12½ times the privilege of making loans.

In any event, I hope to see that the near-

banks in the future will be made subject to the same regulations as we are.

COMMISSIONER MACKINTOSH: I think that is very relevant, Mr. Hebert. I think some of my colleagues will want to pursue that discussion further later on. What about competition in hours of business? This touches the near-banks. They follow varied hours of business for competitive reasons.

MR. WADSWORTH: Is that the question? I think it is a factor, this question of hours of business. We in the banks have studied it for quite some time and actually we have tried an experiment, you might call it, in a number of shopping centre areas, which have a bearing on this branch expansion program of staying open for extended periods, but it didn't seem -- based on that limited experiment -- to be an important factor in the choice of an institution, but I would suggest that probably it is more important in some areas than it is in others.

COMMISSIONER MACKINTOSH: You are, I would gather, quite free to establish what hours of business seem desirable for banking?

MR. WADSWORTH: Well, we are, subject to the days that we must remain open for business.

COMMISSIONER MACKINTOSH: Yes.

MR. WADSWORTH: I think that we would, if possible, like the privilege of -- in addition to closing on Sunday -- to have the choice of some other day. There might in time be areas where you would open on Saturday and close on Monday, in the habits of that area, which would give it more freedom.

COMMISSIONER MACKINTOSH: This is something you think most of the banks will continue to experiment with?

MR. WADSWORTH: Yes, and I think we will continue to watch it very carefully.

MR. BOYLES: In considering this particular point, one has to take due consideration of the existing provisions of the Bills of Exchange Act. We may very well have to seek some revision of the respective section. The Bills of Exchange Act names the days, and there is a problem there, but that also is under study.

COMMISSIONER MACKINTOSH: It wouldn't affect the hours, however, within a permissible day?

MR. BOYLES: Not from the standpoint of providing the normal services.

COMMISSIONER BROWN: How about competition in hours of business, not in the context in which it was answered, which was as between banks and other financial institutions, but as between one bank and another bank. You compete now on location; why don't you compete on hours of being open with one another?

MR. WADSWORTH: I think we do compete in hours of being open, but there again I think that any change by one bank, if it gave them a competitive advantage, would be quickly followed by others.

COMMISSIONER BROWN: Has it been tried?

MR. WADSWORTH: Yes, it has been.

MR. MULHOLLAND: In certain areas in the large cities, particularly in Montreal, the chartered banks have had to compete on certain hours

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of others.

[illegible]

[illegible]

[illegible]

in the [illegible]

in the evening; Friday evening, for instance.

COMMISSIONER BROWN: Did they all get together and agree on this, or did one try it?

MR. MULHOLLAND: No, it was only the banks in that particular area where the banking habits were thought to be different.

COMMISSIONER MACKINTOSH: But did all the banks in that area try it?

MR. MULHOLLAND: Yes, all the banks tried it.

MR. WADSWORTH: May I just add to that. It could be done, and there are differences in times between different areas; I mean, mining areas, for instance, to meet payroll requirements and a bank or banks may stay open at different hours, but between banks and with the exchange of business between banks by individuals, I think you could run into quite severe difficulties with encashment of cheques and certification of items if you didn't have a uniformity of hours within a set area.

MR. MULHOLLAND: This also involves, I think, a question of staff. We have to compete in the market for staff, and the working hours in any other financial office or an insurance office must be more or less matched by the hours that the staff in the bank are expected to work and, indeed, there are labour laws in most provinces to protect these staffs.

There is so much work to be done before the bank is opened and so much work to be done after

the closing hour, and therefore the hours of opening must be compressed into a certain area; otherwise it would mean employing overtime staff or additional staff for special duties, which would increase the costs of our services quite importantly.

COMMISSIONER BROWN: If you had automation, if you got these things done automatically and more quickly, it would mean that the public would have longer banking hours?

MR. MULHOLLAND: Our studies are not quite complete on that point. This question of electronic data processing still has considerable mystery for us in that area, but I think that what these new procedures will do is that it may enable the staff to handle a greater volume of work without too much of an increase in the costs. I don't think it will reduce the working hours for any offices, particularly the larger offices where the equipment will be most convenient. I don't anticipate that, but it could happen that the larger offices might be able to get along for a time with fewer staff, but then with the growth in the banking business that slack will undoubtedly be taken up.

MR. WADSWORTH: I think -- if I might add something in that connection -- that it is a question of providing the services that are required in the time that is required, and to the best of our knowledge, with our periods of opening later on Fridays, that we are not aware of any area where

we are not providing the service to the public that they feel is necessary. I think if conditions change that hours may change as well.

COMMISSIONER MACKINTOSH: Does that mean you do not feel that this is a fairly influential factor in the competition of the near banks with you for deposit business?

MR. WADSWORTH: We haven't felt so up to this time, although it is a subject that is so current, our ideas or our plans could change at any time.

COMMISSIONER MACKINTOSH: The obvious and striking thing, of course, about our banking system is the small number of our banks. What prevents, say, a subsidiary of a foreign bank from being set up in this country?

MR. WADSWORTH: Apart from the requirements imposed on corporations for obtaining a charter for a bank and meeting those requirements, I think the biggest factor would be that under a national banking system such as ours, our wide distribution of branches, in order to compete effectively and on a national scale it would require a reasonable branch representation and that would take a considerable amount of time as well as, I would suggest, a large amount of capital before one new bank could be entirely competitive, although we have seen evidence, as you are aware, of new banks being chartered in Canada, and of which there is a representative at the table this

afternoon.

COMMISSIONER MACKINTOSH: Yes, but it is not very frequent?

MR. WADSWORTH: No, I think that there may be other reasons, but the reason I mention is probably one of the more important considerations.

COMMISSIONER MACKINTOSH: The required minimum capital requirements of the Bank Act, but I take it this is not a necessary restriction, regardless of the Bank Act, if you are going to start a bank with that amount of capital or more?

MR. WADSWORTH: I wouldn't think so.

COMMISSIONER MACKINTOSH: Have there been any attempts or indications that other financial institutions are tempted to break into banking?

MR. WADSWORTH: You mean by applying for a charter or doing bank business without a charter?

COMMISSIONER MACKINTOSH: Applying for a charter. Through the front door.

MR. WADSWORTH: Not to my knowledge, Dr. Mackintosh, although if anybody can add to that I am sure they will. I have no knowledge of such a thing.

COMMISSIONER MACKINTOSH: You think the main obstacle to carrying on a banking business under our system is that you have to set up a considerable network of branches and get, as it were,

a sales and service force over a wide area and that this is a costly and somewhat speculative venture?

MR. WADSWORTH: And would take quite a considerable amount of time. I think that is a factor, although, as we have mentioned in our brief, we feel we are subject to very direct competition -- and that is why I asked the other questinn as a result of your question -- by those who have not obtained a charter as a chartered bank, and obviously we can only assume that they are operating in the way they wish to without it.

MR. BOYLES: It might also be fair to say, because of the manner in which the current group of chartered banks are serving the country, it must prove to be sort of a discouraging factor to any foreign bank or others who might like to form a bank here; in other words, if the chartered banks are providing an excellent service now and have equipped the country with this wide range of branches and we do feel that they are providing adequate service, efficient service.

COMMISSIONER MACKINTOSH: I think that is true, Mr. Boyles, although it is not always the keynote of the speech at the annual meeting! This is so meagre a field, we wouldn't think of looking at it!

Coming back to the questinn of rates, with which I started, I notice that changes in rates on deposits are, I think, usually announced by the Canadian Bankers' Association and I take it, therefore,

are agreed to by them, and you point out that other lending rates of various terms tend to be pretty uniform, which you contend is the result of competition. Your rates on foreign currency deposits, I think, vary more than your rates on domestic deposits, and are not uniform unless you catch them at a particular section.

Why is it possible or necessary to operate with very flexible rates in these foreign currency deposits and with very sluggish and uniform rates on the domestic deposits?

MR. SHANNON: I think the answer to that is in the international deposits we compete with the world markets and have to meet the rates that are set pretty well in the international financial centres, and these rates vary from day to day and we must meet them. At any given point any group of Canadian banks probably would quote almost the same rates.

MR. BOYLES: And also there is no ceiling on the prospective lending rates.

MR. WADSWORTH: I think I should also add, if I may, that there are wide fluctuations and I think it is probably the supply and demand in the dollars that relates to a great deal of these non-Canadian dollar deposits.

As to the point you mention as to the Canadian rates being uniform, I would like to make a comment on that point. It is true on deposit rates, relating to savings accounts and the like;

they are announced through or announced by the Canadian Bankers' Association, and the reason for that is that they apply uniformly throughout the country, and we think that that is another advantage, that the savings rate change is not confined to certain areas, or in the bigger financial areas, as it affects literally millions of customers, but the fact that they are announced by the Canadian Bankers' Association does not imply that the rate is set by the Association as such. As I mentioned earlier ---

COMMISSIONER MACKINTOSH: I did not assume so, but if they are announced with one voice, they are agreed to beforehand?

MR. WADSWORTH: There are discussions, obviously, that go on beforehand, and I think in practically every case where there is a change of rates in any of the major areas it has been initiated by one bank that felt a change should be made and we are prepared to make it.

In the Canadian situation I think there we are dealing with a somewhat retail basic, as against large wholesale blocks of money. In the Canadian deposit receipt area we are dealing in larger amounts, but these rates vary quite often in relation to the general market rates, treasury bill rates, and the like.

COMMISSIONER MACKINTOSH: Do not the banks act pretty well in agreement in regard to deposit rates on corporation deposits, Canadian corporation deposits?

MR. WADSWORTH: On these deposit rates I was speaking to you about?

COMMISSIONER MACKINTOSH: Yes?

MR. WADSWORTH: Yes, up to the period of one year, although there again the changes in the rates I think are invariably suggested or brought about by one bank advising the others they are going to make a change in the light of what may have happened to the short-term money rates. Above a year you might well get two quotes from two different banks, although I would think they both would quote pretty well on the market, but these rates are not uniform.

COMMISSIONER MACKINTOSH: Well, I am less concerned with whether the rates are arrived at in the market, or to some degree by agreement, than I am in their flexibility and sensitive response to monetary conditions.

Now, would you expect that assuming for the purposes of argument, assume that the ceiling on lending rates is removed -- and this, no doubt, would affect other rates -- would you expect it to add substantially to the flexibility and sensitiveness of not only lending rates, but deposit rates?

MR. WADSWORTH: I think that it would. I think that the wider area would naturally lead to that answer.

COMMISSIONER MACKINTOSH: Now, you have to remember that in the last half dozen years or so, a little more, there have been periods when

rates were restrained by the ceiling and the pattern was undoubtedly affected, but prior to that there have been long periods in your system when the ceiling was something that could be neglected, it wasn't of much practical importance, and my recollection is that the record does not show any extreme sensitiveness of other rates in the system.

MR. WADSWORTH: I think in the latter period you are referring to, Dr. Mackintosh, while there may have been long periods with, say, slight or no change, let us say, in the prime rate , there was a wider range of rates applicable.

COMMISSIONER MACKINTOSH: Yes.

MR. WADSWORTH: If we take the period from 1944 on to 1954, there was a certain stability then in minimum rates throughout the financial picture. For most of the time the bank rate remained at 1½ per cent and went to 2 per cent; the savings rate varied from 1½ to 2 per cent; the so-called prime rate remained for practically all that period at 4½ per cent. However, within that range there was a relatively wide range of rates. There were rates on special government guaranteed loans and security loans that were below the prime rate; there were other rates that were above it. I think competition had its effect at the top end because the whole level of rates was lower, but the range was considerably wider in that period than it has been in the last few years.

MR. NEAPOLE: During that particular period of time there was, in fact, a very restricted money market compared to that of today. My suggestion is that without the 6 per cent figure there would be much more flexibility afforded to the whole money market, whether chartered banks or near-banks or the day-to-day money market. There was a wide spread between the 4½ to 6 per cent. There were various little divisions in there.

COMMISSIONER BROWN: If this 6 per cent ceiling were removed you obviously think there would be a return to this sort of situation. Do you think, in the same context, that call loans might then really become call loans? I am thinking of the loans to investment dealers and stock brokers.

MR. NEAPOLE: That is a different question, is it not?

COMMISSIONER BROWN: It is all part of the same question.

MR. NEAPOLE: Do you mean call loans would become real call loans?

COMMISSIONER BROWN: You are talking about the fanning out of the rates and kinds of loans and the money market and loans. In between there are call loans of investment dealers which are not quite as much call loans as they are in New York. Do you think this would provide greater variety and facilitate the cash management of the banks themselves?

MR. NEAPOLE: Yes, that is conceivable. I would look, perhaps, for more variation then.

THE CHAIRMAN: If the 6 per cent ceiling were removed what effect would that have on the near-banks? As you say, the near-banks have not the network of branches that you have, and the network of branches gives you great strength and contact with a very wide range of the public. The near-banks today are competing because they have not the 6 per cent ceiling, to some extent. Is not that so?

MR. NEAPOLE: Yes, to a large extent.

CONGRESSMAN PATMAN: [illegible]

ceiling were removed [illegible]

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become call loans. I am thinking of the [illegible]

investment centers and [illegible]

MR. [illegible]: [illegible]

as it was?

CONGRESSMAN PATMAN: [illegible]

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MR. [illegible]: [illegible]

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CONGRESSMAN PATMAN: [illegible]

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MR. [illegible]: Yes, [illegible]

[illegible]

THE CHAIRMAN: [illegible] per cent ceiling

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out ceiling, [illegible]

THE CHAIRMAN: They are in an area which you are not able to tap because of that.

MR. NEAPOLE: Yes.

THE CHAIRMAN: Once you are able to tap that area, what would be the effect on the near banks? Would they be able to continue?

MR. NEAPOLE: Yes, I believe they would. They definitely fulfill a certain function in the country.

THE CHAIRMAN: I am sorry, I may have anticipated something.

MR. WADSWORTH: I presume we will have a chance to comment on that further, Mr. Chairman?

THE CHAIRMAN: Perhaps if you want to comment on this now you should.

MR. WADSWORTH: The only general comment I would like to make on it is that I think a change in the ceiling would affect the rates. It depends whether you are talking about deposit or lending rates. I do not think it would affect, to any material extent, the competition in the real sense, where both sides are playing under the same rules. I think the figures we have already submitted clearly indicate it is more than straight competition. Our relative share has been declining at a rather rapid rate.

THE CHAIRMAN: I am aware of that, but at the present time the near banks provide an element of competition, for what it may be worth.

They do provide some competition, and in the banking system as such we have only eight banks now, and if the other type of competition gradually became less and, perhaps, eventually disappeared, the banks would find themselves in a much less competitive world than they are now. Would that be a good development or not?

MR. WADSWORTH: I would not say that would be a good development, Mr. Chairman, but we have not, I do not think, suggested anywhere that we wish to restrict the so-called near banks in their activities and in competition which is proper. It is a question of being able to compete on somewhat equal terms. I think the major ones are well-founded and sound, and I think are quite able to compete. However, we think that the financial requirements of the whole country could be better served if there was more direct competition, without holding back one area.

COMMISSIONER MACKINTOSH: I was interested in Mr. Neapole's view that development of the money market and other markets, aside from this other question of ceiling on rates, was tending to pervade the whole financial system; and, as I understood, it had a tendency to have an influence towards more flexible and sensible rates right through the system.

I can remember, many decades back, when the banks began on short-term loans to the government by a calculation that savings deposits cost

[illegible] to provide some [illegible] and [illegible] the [illegible] systems [illegible] [illegible], and if the other [illegible] [illegible]

the banks would [illegible] competitive world [illegible] be a good development [illegible]

Mr. [illegible] I would [illegible] say that would be a good [illegible] but if we have [illegible] I do [illegible] that we wish to [illegible] their [illegible] their activities and [illegible] It is a question of [illegible] with equal [illegible] well-[illegible] able to [illegible] financial [illegible] be better [illegible]

[illegible]

them 3 per cent and 1½ per cent was not too much to add to that, so 4½ per cent was a good equivalent for a modern treasury bill rate. This was many decades back, and I think you have had a gradual step-by-step development up to the present money market, and I assume this would go further. You have no desire to go over to the British system of rates, with fairly fixed links, where most rates move with the bank rate and not just in sympathy with it, but compulsorily with it, almost. Have you any views on that?

MR. MULHOLLAND: I do not think that would be adaptable to this market, Dr. Mackintosh. The English market is a very closely knit one, and the rates there do tend to move with exact precision, almost.

COMMISSIONER MACKINTOSH: Well, I gather that a lot of rates are stated as "bank rate plus 'X' ".

MR. MULHOLLAND: Yes.

COMMISSIONER MACKINTOSH: Down to a certain minimum?

MR. MULHOLLAND: Yes.

MR. LORENZO HEBERT: May I suggest that the condition in London is altogether different from the one we have in Canada, because they have such a big supply of international funds that go in and out that this supply has a much larger influence on the whole structure of rates than the smaller supply that we have here in Canada?

COMMISSIONER MACKINTOSH: Yes, it is quite a different market.

I have just one other question I would like to ask, Mr. Chairman. As far as I know, there has been little in the discussions so far about the nature and position of the Canadian Bankers' Association itself. The Association has, I gather, at least one formal function of looking after the clearing system. Is that not correct? Some other official functions that it did have in the distant past have disappeared. That is, aside from its being a form of Association among the banks, where they may discuss their mutual problems, has it any other official function than the clearing system? Is there still justification for the special legislation concerning it?

MR. MULHOLLAND: Its main day-to-day function, I may state very generally, Dr. Mackintosh, is that it is a clearing house for the exchange of ideas between the banks, particularly the general managers who comprise the executive council of the Association. In any industry there is always a common interest in common problems, and how best to meet these problems is always of constant concern, to make sure in the case of the chartered banks that they are providing the service that the public requires. After all, the chartered banks are essentially a service industry, and I think that in the case of a service industry it must be very alert at all times, to make sure that all segments of the public are being

taken care of; and the only way to do that is to debate these matters freely.

COMMISSIONER MACKINTOSH: Do not misunderstand me, Mr. Mulholland. I was not suggesting it did not serve a useful function. That would not be sensible and it would be impertinent of me to suggest it. I was merely struck with the fact that it has had, over the course of many years, various official functions. I seem to remember it once handled the central gold reserve, and I have some vague recollection of its performing some ceremonial function of burning bank notes at one time. It had these official functions which established it almost as a quasi-governmental association, and they have disappeared, and it is much more now an association among the banks for their own proper purposes. I was just inquiring if you have any thoughts in that area. I think that is all I have on this area, Mr. Chairman.

COMMISSIONER BROWN: One question on the Canadian Bankers' Association. In the act of incorporation it refers to:

> "Members of the Association shall vote and act in all matters relating to the Association through their chief executive officers. For the purposes of this Act the chief executive officer of a member shall be its general manager or cashier ......"

Do you suggest that all you general managers should vote yourselves out of office by having that particular

section of the act changed? Does this weaken the C.B.A., that the chief executive officers of the bank are not represented on it?

MR. MULHOLLAND: To your first comment, Mr. Brown, there are many times when the general managers would welcome voting themselves out of this office!

COMMISSIONER BROWN: Perhaps the presidents find it handy to have you there.

MR. MULHOLLAND: That comment, of course, does not relate to presidents.

To your second comment, the strength of the Association and what it does, what it accomplishes, is in no way weakened by the fact that the members are the general managers of the banks rather than the presidents. Is that the question that you are referring to?

COMMISSIONER BROWN: Yes.

MR. MULHOLLAND: Of course, as you are well aware of the historic situation in that regard, when the Act was passed in 1900 the presidents of the banks in those days, and until quite recently, were chosen from among the ranks of the directors. They were not professional bankers, if I may use that term. They were men of great banking stature, but they had not grown up in their respective banks. The situation today is that all the presidents have come up through the ranks of their bank and are thoroughly experienced in all phases of banking and they are, in most cases, the chief executive officers

of their respective banks.

I do not want to state an absolute here, but there are many pros and cons as to whether or not the executive council should consist of presidents or general managers. The day-to-day problems and responsibility of banking really, in the final analysis, revolve on the shoulders of management. To that extent I think that management should be the ones who have the day-to-day problems of the Association. Quite naturally, the chief executive officers of the banks, in their respective banks, lay down broad policy lines for the operation of those banks. If the executive council arrived at a broad policy decision at the Association level which was not compatible with the views of the chief executive officers of the banks or, indeed, of any one bank, I doubt if that broad policy decision would be put into effect. But one of the most important responsibilities of the general managers who are the members of the council is to have frequent meetings with the Governor of the Bank of Canada. He attends these meetings, and they are the quarterly meetings of the Association. I think it might be fair to say that the Governor should be talking with the general managers rather than the presidents at that level and on those occasions; and he should be talking to them on general and specific lines relating to the monetary position at the moment and, perhaps, to the trend of objectives, both near and future, of monetary policy, in very general terms. Also he

wants the general managers and asks them to discuss with him, in very general terms, the trends of banking.

This is the high level operation of the Association, but there are countless more routine matters that the general managers discuss at the Association level and among themselves, even when they are not meeting, almost on a day-to-day basis at times, and I doubt very much if the presidents would wish to devote that time to these matters in connection with the Association. That is the long answer, Mr. Brown, to the question.

COMMISSIONER BROWN: I will throw another question out that has been tossed at us from various points of view. At various times people have asked why should not the Combines Act apply to the banks.

MR. MULHOLLAND: Apply to the banks or to the Association?

COMMISSIONER BROWN: To the banks.

COMMISSIONER MULHOLLAND: That would be in connection with the setting of lending rates.

COMMISSIONER BROWN: Charges, deposit rates?

MR. MULHOLLAND: I shall deal with lending rates first and then the service charges. There is a multitude of service charges. On lending rates the Association does not act in this respect at all. I think Mr. Wadsworth mentioned a few minutes ago that generally speaking one or perhaps two or more banks sense that the prime rate, for instance, should be moved in one direction or another. There is never any meeting on a matter of this kind. They decide to take action individually and other banks follow. I might be able to describe more accurately that when rates are coming down, if one bank feels that the rates should be dropped, generally speaking the message gets through to the other banks that there is a change. I should not put it that way really, for the banks are all pretty much in tune in a uniform way with what is happening and there is very little lag between banks and their adjustments of the rate schedule. This is observed, of course, in New York where one of the large American banks announces a drop in rate, and the other banks follow. It is not necessarily the same bank each time, and in effect, Mr. Brown, that is what happens in Canada. You usually find that one bank announces a drop in rates and the other banks follow. The bank

that drops its rates here, or any bank anywhere, if it was not very sure that that was the indicated trend, pretty soon would have all the loans it could possibly handle and would not be able to take care of any more of its customers. It would be almost immediately loaned up and in a very difficult position. So, the decision is taken very deliberately and not to gain any competitive advantage.

Regarding the Combines Act, I am not too well versed in the legal position but I question whether this Act would or does apply to an industry which supplies services.

COMMISSIONER BROWN: It does not. That is the whole point of the question.

MR. NEAPOLE: There is a legal opinion about that.

COMMISSIONER BROWN: We are satisfied about that. I am asking you about the argument that has been put forth that it does not matter, because somebody starts it and everybody else has to follow it. So, this is not an argument against making it applicable, or some similar legislation.

MR. MULHOLLAND: And, insofar as rates are concerned generally, it has been mentioned here before frequently but any rates that are established are minimum rates, and when you are dealing with a prime rate as between 5-3/4 per cent, which it is at the moment, and 6 per cent, your area of manoeuvering is pretty narrow, but when it is 4½ per cent or ½ per cent you have lots of room to manoeuver around,

and therefore rates under those conditions are very competitive. They must be.

Referring for a moment, if I may, to various other matters that are discussed at the Association level, which are rates and rules generally which do not include interest, either deposit or loan interest rates, these rates and rules generally are for services that the banks are supplying.

I do not want to leave the impression that we are endeavouring to plead anything here, but we know that in a multitude of our services the costs of these services exceed, and sometimes to quite a substantial extent, the fees or charges that we make for these services. We are not able to charge fully.

What I am attempting to say, Mr. Brown, is that we are not able to charge fully in each area of services which would enable us to recover the costs plus a reasonable profit for that particular service. There are a multitude of these matters, and the prime purpose of the bankers meeting in this way is to ensure that we are providing the services that the public wants at a fair and reasonable price, and that this price is applicable throughout the whole of the country and not just in certain areas. You might wish to add to these comments, Mr. Boyles?

MR. BOYLES: No, I have nothing to add at this stage.

MR. NEAPOLE: The price of a lot of these services is set by competition from other sources such as safe keeping charges, safety deposit boxes of trust

companies, and so forth. The result is that even the smallest branch customers get the advantage of the competition in the centres where competition does exist with other agencies.

COMMISSIONER BROWN: This is an argument for having the same charges throughout the Royal Bank of Canada.

MR. NEAPOLE: Yes.

COMMISSIONER BROWN: But it is not an argument for having the same charges throughout the whole banking system.

MR. PATON: I think the competitive factor between banks would answer that question as to parity, Mr. Brown.

THE CHAIRMAN: We shall now adjourn for ten minutes.

COMMISSIONER LEMAN: I have one question on this matter, Mr. Chairman.

THE CHAIRMAN: Well, we might come back to it.

COMMISSIONER LEMAN: This is going to be very short.

THE CHAIRMAN: Go ahead.

COMMISSIONER LEMAN: It is just something Mr. Mulholland said a minute ago which I think for the record it might be better to review. I believe you said, Mr. Mulholland, that at a time when a decision is made to come down on loan rates, on the prime rate, initiative is taken, and this is not done to gain a competitive advantage. Do you mean it is not done to

gain a competitive advantage as between chartered banks? It must be done to meet competition from some other sources or to gain some competitive advantage somewhere.

MR. MULHOLLAND: That is so, Mr. Leman. I am sorry I did not make that clear.

MR. PATON: I was commenting, Mr. Brown, on your remark regarding the situation which permitted the charges in the one bank to be the same throughout but this did not necessarily apply throughout the other banks. The competitive factor between banks results in a parity of rates and charges for identical services.

COMMISSIONER BROWN: Does someone else wish to comment on this?

MR. WADSWORTH: I presume we are going to come back to this subject after the recess, but I am just not too clear as to what Mr. Leman said, or perhaps I missed what Mr. Mulholland said. I did not get the remark that rates come down not because of competition. I can confer with him at the break.

THE CHAIRMAN: I should like a little clarification on this myself. Perhaps with a break of ten minutes we can come back to it.

--- Short recess.

THE CHAIRMAN: We shall now resume.

MR. MULHOLLAND: Mr. Chairman, may I please add a sentence to my remarks just before the break? I should have been thinking in the area of monetary policy, and this may answer a thought in Mr. Leman's

mind. One of the prime objectives of monetary policy is to register a relatively uniform response in the area of lending rates generally, and therefore bank lending rates must act in a general uniform way within a relatively short period of time.

THE CHAIRMAN: May I ask this question? I am not quite clear about this. Just how is the prime rate established? Could you describe the steps that may be taken or whatever may be done to establish the prime rate?

MR. MULHOLLAND: Are you referring, Mr. Chairman, to what classifications of borrowers are entitled to a prime rate?

THE CHAIRMAN: No. How do you fix the prime rate of whatever it is now --

MR. MULHOLLAND: It is 5-3/4 per cent.

THE CHAIRMAN: How do you establish 5-3/4 per cent as the prime rate?

MR. MULHOLLAND: I can say that 5-3/4 per cent under today's circumstances is in line with other rates that have an effect on that decision.

THE CHAIRMAN: Yes, but who decides that?

MR. WADSWORTH: May I add a comment, Mr. President?

MR. MULHOLLAND: Yes.

MR. WADSWORTH: I mentioned it earlier but I would like to mention again that I think the rate is decided by one bank. It may be that two banks are thinking along the same line at the same time that it would be appropriate in line with interest charges to

mind. One of the [illegible]

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Chairman, [illegible]

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make a change in the prime rate, whichever way it might be, and a change is instituted in the rate. On some occasions there are discussions as to the implications this might have upon other rates, but it is initiated by one or more banks thinking along the same line.

THE CHAIRMAN: Yes, that may be. I take it that the banks come to it eventually and agree or are perhaps forced to follow the same rate, but surely one bank does not out of the sky say that it is going to establish a prime rate of 5-3/4 per cent, and then all the other banks follow automatically?

MR. NEAPOLE: All that I can say is that although I was not here at the time, as I remember it there had been a second reduction in the Bank of Canada rate. You form judgments about these things, and you say to yourself and your group of committee within your own bank and so forth, "It is time we reduced our own prime rate." Having made this judgment you tell the other banks you are going to do it, or as a rule you tell them. In this particular case we did and we said that we were going to announce a reduction of a quarter of one per cent effective November 16, and we made our announcement. More or less simultaneously one of the other banks made the same kind of announcement and said effective November 15. That got us into various mix-ups with divided accounts and so forth, but we stuck to our original effective date of November 16. But you do arrive at certain judgments in these matters.

THE CHAIRMAN: Well, your bank arrives at that judgment entirely on its own.

MR. NEAPOLE: Yes, sir, in the initial stages.

THE CHAIRMAN: And it is not necessarily as a result of consultations with other banks at all?

MR. NEAPOLE: No. We decide that it should be done. I can remember a case which is vivid in my memory where a certain bank president called another bank president and just said that he was going to reduce the rate, and that was that.

THE CHAIRMAN: Is that the usual procedure?

MR. NEAPOLE: It is not uncommon.

THE CHAIRMAN: But what is the usual procedure?

MR. NEAPOLE: Well, I would say that perhaps that is more usual than uncommon.

MR. WADSWORTH: I think the distinction, Mr. Chairman, might be that at this time in this area of consultation that a bank will make a decision as to what it is going to do and then it may advise the other banks in consultation, and an effective date may or may not be decided upon but the decision is arrived at before there is advice passed on to the others.

MR. [illegible]

MR. [illegible]

[illegible]

MR. [illegible]

[illegible]

the rate, and [illegible]

THE [illegible]

MR. [illegible]

[illegible]

MR. [illegible]

that is [illegible]

MR. [illegible]

Chairman, might be [illegible] consultation [illegible] banks in [illegible] not be [illegible]

COMMISSIONER LEMAN: But that is on the down-swing in rate.

MR. WADSWORTH: Or on the upswing.

COMMISSIONER LEMAN: On the upswing: do you say that if one bank that is a significant factor in this system says it is going to reduce the prime rate the others cannot do very much but follow? If one bank all of a sudden feels that the rate has to go up it is not quite so certain that the others have to follow, is it?

MR. WADSWORTH: No, it is not.

COMMISSIONER LEMAN: Does it take its chance, or what?

MR. BOYLES: Perhaps I might add something in that respect. Usually, the considerations that prompt a bank to suggest an upward or even a downward revision of the prime rate have in mind the factors at the time. In other words, it might be a case of money; it might be competition; or it might even be a signal through Bank of Canada sources. There is usually something that prompts the same thinking, and then it is fair to say that the banks do have engagements and discussions.

THE CHAIRMAN: Yes, but would one bank raise the prime rate if it thought all the other banks would stay at the old rate?

MR. BOYLES: I would say this, that usually the same considerations prevail. In other words, what affects one bank at a time usually affects the others, and it seems to be automatic that they should move together.

COMMISSIONER BROWN: May I ask a question here? Do you say that the points that cause one bank to suggest an upward revision -- to whom is this suggestion made?

MR. BOYLES: It would be among the banks. In other words, they would prompt the discussion.

MR. NEAPOLE: I can say something, speaking for myself, in respect to this matter. Suppose, for the sake of illustration, when this tight money business started our prime rate was 5-3/4 per cent. Having regard to the rate at which rates were going up I would have had no hesitation in suggesting to my committee that we go to 6 per cent regardless of what the other banks did.

MR. MULHOLLAND: If I might add to that, Mr. Chairman, I would say it is my view that considerations suggesting increases in the prime rate are usually because of very compelling reasons, such as the fact that loanable resources are tightening up. The reverse would be the case if loans were going down. Banks are anxious to make loans, and that would be another compelling reason for all banks to act more or less at the same time.

MR. BOND: This is the case in most other countries. You find a conformity in rates, and the rate adjusting itself very fast.

THE CHAIRMAN: I am not surprised at finding conformity of rates. I think that that would almost inevitably follow.

MR. BOND: They usually follow the big banks.

THE CHAIRMAN: On the other hand, I would have thought there would be in this type of business a degree of discussion about it. However, I may be entirely wrong.

MR. PATON: Perhaps I could speak to that. If I have given you that impression then I will say it is not exactly correct. But there is undboutedly discussion between the banks. The same factors affect all of us in practically identical degrees, possibly dependent upon the constitution of the particular bank's liabilities. An increase in, perhaps, the savings rate might be more effective in one bank than another. Likewise, on the other hand, on the lending rate one of the important factors might be as between the rates we pay and the rates we collect. I do not think there is any magic in arriving at a decision as to whether November 14, or November 15 or November 16 was the best day upon which to make an adjustment. The matter is that the adjustment would inevitably be made in the light of the monetary situation and the trend at the time. There is undoubtedly full knowledge as to the thinking of each bank with respect to the rate adjustment.

THE CHAIRMAN: There is full knowledge ---

MR. PATON: Pardon me; there is knowledge, but not full knowledge, of the actual thinking of the banks. There is general knowledge of the trend because the same factors are affecting each one of us.

THE CHAIRMAN: What about the other rates? How are they established once the prime rate is

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established? Before we leave the prime rate, the prime rate is very, very seldom changed, is it? Once a certain rate is acknowledged, no matter how you arrive at it, and once it becomes set as the prime rate, it generally stays there for a long time, does it not?

MR. NEAPOLE: Depending upon conditions. We have had some fairly quick changes in the past. There is a list of them here. But it becomes the base rate for all the others. As a rule, charitable institutions have one-quarter of one per cent less or something like that; provinces possibly have a quarter of a percent less than that, and so do different municipalities. They all fit into a framework which through the years has become, let us say, a picture of their own rough position in the market relative to one another.

THE CHAIRMAN: Then, the other rates are all relative to the prime rate?

MR. NEAPOLE: Yes.

THE CHAIRMAN: I suppose the scale of rates is the same with all banks?

MR. NEAPOLE: Yes.

MR. BOYLES: May I ask a question? When you say "all other rates", do you mean the rates on deposits?

THE CHAIRMAN: No, loan rates.

MR. BOYLES: I would like to say -- and, perhaps, put some emphasis on it -- that this so-called prime rate is a minimum rate. In other words, it is a fluctuating 6 per cent ceiling when there is something

lower than 6 per cent. It does not neeessarily mean that the banks apply that prime rate throughout. Risk factors and other factors come into play, so there is competition in the degree of difference there is between the prime rate and the ceiling.

MR. WADSWORTH: And there are no set rates. Between the prime rate and the actual rate it would be that bank's assessment of what it would pay, or what it would charge.

THE CHAIRMAN: My understanding from what you have said is that once the prime rate is set at a certain point, no matter how you arrive at it and whether or not it is mutually adopted, a bank at any moment could, on its own, fix a lower rate.

MR. NEAPOLE: Yes.

THE CHAIRMAN: Or a higher rate?

MR. NEAPOLE: Yes.

THE CHAIRMAN: There are no conditions of any kind, or arrangements, that would limit the freedom of any bank to act independently?

MR. NEAPOLE: None whatsoever.

COMMISSIONER MACKINTOSH: Except that the banks all have to live together.

MR. WADSWORTH: Well, we live in the same country. Before we leave the question of interest I would like, for the record, to express a view that probably may not be in conformity with a view that was expressed formerly, if I understood it correctly. That is that reductions in the lending rate represent competition -- we are speaking of competition within

banks, and I am thinking of your question, Mr. Leman of a moment ago before the break that you addressed to the President of the Association -- reductions as well as increases, could, in my opinion, well be and are, a sign of competition.

COMMISSIONER LEMAN: Would you not say that they must be a sign?

MR. WADSWORTH: Yes, but I gather from the way you put the question before, and the answer given, that you might have got the other impression, and I did not want that to remain if I could help it.

COMMMSSIONER MACKINTOSH: I would still think, Mr. Chairman, as of today, no matter what I think tomorrow, that aside from this question of how the rates are set the more important question is whether you can get sufficient flexibility into these rates so that all different rates become appropriate, and the banks have to consider their appropriateness. I think it follows that the rates that are set do have a closer relationship to the realities of the market and the financial system than if they lie dormant for long periods until some bank gets up sufficient energy to propose that this long standing arrangement should now be changed. I would like to hear the various points of view with respect to more change and flexibility which would affect the whole fan of lending rates and also deposit rates.

MR. NEAPOLE: So would I, sir.

MR. WADSWORTH: And I think you would if we were not subject to the restrictions.

THE CHAIRMAN: If the 6 per cent ceiling is

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ever raised you will all be on t he threshhold of Valhalla.

COMMISSIONER LEMAN: A little earlier when we talked about the competitive areas as between banks, and about the opening of branches, etcetera, I meant to ask you how far someone will walk in the rain to get a quarter of one per eent on deposits.

MR. PATON: Possibly, if they were too far away they might do their banking by mail, which is one of our many services -- certainly for a quarter of one per cent.

COMMISSIONER LEMAN: And let the postman walk in the rain.

MR. BOYLES: We provide umbrellas.

COMMISSIONER LEMAN: We have covered a good part of this section, and I would like now, Mr. Chairman, to talk not so much about competition between the banks themselves but competition between the banks and other institutions that were mentioned. One of the main recommendations, as the chairman has pointed out, is that the 6 per cent ceiling be removed. Through yesterday we asked you a few questions on what would be the effects of this, and I believe in answer to a question of Dr. Mackintosh you indicated that you think it would enable the banks to provide for a broader and better spread/ or fan of rates at any one time. For instance, the difference between the prime rate and a non-prime rate would not have to be so compressed as it has been at times. I think you also told us yesterday that it might cause the banks to be able to move more aggressively into areas of lending in which they are not very active.

Can you tell us what those areas of lending might be that would relate strictly to the removal of the 6 per cent rate, as opposed to the areas we will talk about later which are tied more into the removal of the prohibition against taking mortgages as security. Is it more freedom in the personal loan sector that will result from this? What are the sectors in which the banks will obtain more freedom to operate?

MR. WADSWORTH: I think one of the areas would be the loans of a term nature, where in the opinion of the bank the loan could still be entertained with these additional security factors that you have mentioned, although rates in the markets would make a rate higher than 6 per cent appropriate. Perhaps some of the procedures already followed in relation to consumer installment loans might change in conformity with more flexibility in rates.

COMMISSIONER LEMAN: You did not express much enthusiasm for term loans yesterday. You said that these should be quite limited in view of the structure of the bank's liabilities, and the other assets they have to keep on their books all the time.

MR. WADSWORTH: Well, I trust, as far as I am concerned, that we did not leave too strong an impression to that extent. I think there is a place for term loans up to a reasonable amount in any loan portfolio, and subject to the availability of funds particularly in the areas where there are not other sources of accommodation available.

I made a brief reference this morning --

and I do not want to go back to it -- to the Industrial Development Government Bank. I would be quite prepared to produce any evidence that was necessary to show that over a period of years the banks effectively in the term loan field have loaned more money than the Industrual Development Bank has, particularly in times of monetary stringency when there were other sources of funds available. Unquestionably, there are certain times when the banks should not draw ... a bit from that area, but I would like to see the funds available to enable us to entertain a reasonable number of term loans.

MR. MULHOLLAND: I think, Mr. Leman, the banks would able to take somewhat greater risks -- that is spelled with a small "r" -- in respect to small developing companies and new companies which, under the present legislation, are not qualified for loans under the Small Businesses Loans Act. These companies have great difficulty in finding, let us say, risk capital, and to a reasonable degree, and on a reasonably sound basis, the banks should be able to be in a position of supplying that capital. They could do so without great risk if they had a somewhat better return from that class of business.

MR. WADSWORTH: I omitted to mention one important area, that of National Housing Act loans, in which we now have permission to take the security, so it has been only the rate that has been a factor.

COMMISSIONER LEMAN: Yes, although it is tied in with a relaxation of taking mortgages.

MR. WADSWORTH: Yes, but you said under existing regulations, and we could get back in under the National Housing Act without any change in security if the rate ceiling were lifted.

COMMISSIONER LEMAN: This brings us back a little bit to the operation of monetary policy. Do you think it would also have the effect in times of stringency to enable the banks to avoid what I would call arbitrary rationing of credit, and let it operate pretty well along the price line, or are there in the banks as well as in some institutions some psychological ceilings on rates that would still force the operations back to arbitrary rationing?

MR. WADSWORTH: I think it would depend upon the degree of control that was necessary, but I do not think there is any question but that the use of rates as an additional means of discouraging lending for purposes such as you mention would be very helpful. You might well reach a stage of extreme emergency where extreme action had to be taken, or where you had to go even further than that and undertake some of the other matters we discussed this morning, but I think it would be of considerable assistance to the banks in controlling the volume of credit in periods of monetary stringency. However, I would not say it would provide the total answer.

COMMISSIONER LEMAN: You would not necessarily be able to avoid rationing completely?

MR. WADSWORTH: No. Whether rationing is the word, or whether it is having discussions, as we went

into it at some length this morning, with customers as to their requirements and the essential nature of them -- I presume you could call that rationing, but it is done on an individual basis rather than having an across-the-board percentage of what you had before.

COMMISSIONER BROWN: Would you call it moral suasion?

MR. WADSWORTH: Yes, possibly, but I feel that "cooperation" is a better expression.

COMMISSIONER BROWN: There must be some way by which you can discourage any borrower?

MR. WADSWORTH: Yes, that is probably true.

COMMISSIONER BROWN: You do not say that the removal of the ceiling would allow the rate to go up to such proportions that it would discourage any borrower?

MR. WADSWORTH: Yes, I think in theory you can carry the rate to such a figure that nobody would touch it under any circumstances, but I think it would be more sensible to use the rate structure to the extent that you think you should, and then approach the problem on a more selective basis and look at the purpose of the loan.

COMMISSIONER LEMAN: I am trying to get at the root of, or the reason for, this problem. Is it because you feel you have a responsibility to somebody who has made some plans and who has already embarked upon a construction program, for instance, so that you feel you must not ruin his business or not absolutely prevent his getting bank credit?

MR. WADSWORTH: Bank credit, if there is no other source of credit, yes, but as responsible businessmen the last thing we would want to do is to see that our actions had some effect on an individual business that could have for that business quite disastrous consequences.

MR. NEAPOLE: Could I put something in here? One of our most important problems when we have tight money are the people who have over-stated their position in a bank loan, after they have promised us that they would go into the capital markets at a certain time, and this is at the completion of a building or the completion of a project, whether it is building sewers in a municipality or buying a fire engine, or what; things of that type.

Now, with very few exceptions, when the rates in the regular markets go up to the point where they don't like it, then they virtually force us by just the sheer challenge in some cases to retain the loan on our books rather than go to the capital market and, of course, we are left with these loans which become stagnant, and obviously you don't just call the municipality, or something like that, for this loan. That is one of our most important problems, and of course, if we were able to charge them what the market would charge them, then they probably would go to the capital market.

COMMISSIONER LEMAN: Does that indicate that at times of extreme stringency, those people who need new money are hurt more than those who already

have loans?

MR. NEAPOLE: Basically, in dealing with applications for new money, unless they have some very, very real emergency -- we don't entertain applications for new credits when things are tough.

MR. WADSWORTH: I think there again you look very closely at the purposes with much more care under those conditions than you would otherwise.

COMMISSIONER LEMAN: As I understand your answer, you would do a little bit of both. There would be more rationing by means of the price mechanism, but you couldn't avoid entirely the personal judgment that has to be exercised by bankers all along the line?

MR. WADSWORTH: Yes, subject to the degree of control that you wish to exercise. I think if the degree of control was not extensive, the rationing -- as you call it -- by the price mechanism would probably work in a great many cases.

COMMISSIONER LEMAN: We were talking about loan rates there. Would it also have the effect of making the chartered banks' deposit rates much more flexible over the cycle?

MR. WADSWORTH: I believe that it would.

COMMISSIONER LEMAN: I think that those are all the questions that I have to ask about the effect of the removing of the ceiling, unless the other Commissioners have some questions.

COMMISSIONER BROWN: I would just like to

get your impression of what business does respond to. There has been some discussion as to the extent to which a change in interest rates affects demands. Is it the rate that business responds to, or is it the availability of credit, the expectations of the market? Which do you think are the important ones?

MR. WADSWORTH: I think they all have relative importance, Mr. Brown; their estimation of the outlook for their particular type of business, but I think that the availability of funds and the price of those funds has an important bearing on their decision.

The term that the funds would be required for is another matter that I think they would take into consideration. Obviously, on a longer term at a higher interest rate the interest factor becomes a more important item in the considerations.

COMMISSIONER BROWN: Well then, when money becomes tight do you find that inventories go up and receivables go up?

MR. WADSWORTH: Not necessarily so. I think sometimes the opposite might be the effect as tight money takes hold, because I think the retailer and the wholesaler, and all the way down the line, give more attention to the collection of their receivables and the control of their inventory than they do otherwise.

COMMISSIONER BROWN: Is their banking kind of within the business world with receivables?

MR. WADSWORTH: Well, somewhere within

that world, but if the facilities of the bank, through loans,were not required, I suppose if one corporation at some stage wished to carry the others, that would be their privilege to do so, but I think even in the natural consequences of a period of tight money there is much more thought given to inventory control and collection of receivables and examination of due accounts than when money is easy.

COMMISSIONER BROWN: It is your impression that all these factors enter into the reaction of business?

MR. WADSWORTH: Yes.

MR. NEAPOLE: Well, I can agree with the inventory part, but I don't agree entirely with the receivables part; there is certainly a lot of response to receivables.

COMMISSIONER MACKINTOSH: I would take it the situation there was that while one fellow was wanting to reduce his receivables, half a dozen other fellows were wanting to increase their payables! It is a bit of a hot dinner plate you can't get rid of.

MR. NEAPOLE: In many cases they already have their inventory when the price comes and then they lean on the receivables as much as they can.

COMMISSIONER MACKINTOSH: Yes, but with regard to the inventory, even the retailer finds his inventory accumulating he cuts his purchases with the wholesaler; he finds his inventory coming up and then finally pushes it back to some place where

they can't get rid of it.

MR. WADSWORTH: And the retailer himself, I would suggest, probably pays more attention to his receivables from the ultimate consumer, and it is therefore getting back to the result that was mentioned this morning; at what stage do some of these controls have an effect on the consumer himself, on his attitude towards it.

COMMISSIONER LEMAN: Don't you think, even on inventories, the fact you are then ordinarily in a boom, causes businessmen to feel that prices are going to go up and they might as well have all the inventory they can get at today's price?

MR. WADSWORTH: Might that not be one of the reasons that those in charge of monetary policy felt that some restraint was necessary?

COMMISSIONER LEMAN: Perhaps. Let us talk now on the second important recommendation contained in your submission, and that is the ability to take mortgage security for lending.

We talked about that yesterday, we did deal with N.H.A. mortgages and a little bit with conventional mortgages. Don't you think this would give the banks quite a tremendous competitive advantage, vis-a-vis the other institutions that have specialized in this particular field?

MR. WADSWORTH: No, I don't feel it would give the banks a competitive advantage. Others have had, as you say, experience in this field and they are in many cases well established in this field.

I think there are areas that probably the banks could serve now and provide a better service than is now being provided for these areas, areas that have been mentioned several times, the areas outside of the larger centres and the smaller areas. The question is, and we believe that some of these areas are not too well adequately served at this time, but I don't think that it would put them in any competitive advantage; nothing like the disadvantage we are at at the moment.

COMMISSIONER LEMAN: Don't any other institutions have as low an average cost of money as the chartered banks have except the Bank of Canada?

MR. WADSWORTH: Well, I have already probably said all I should on the I.D.B. this morning, but in answer to your question, if the banks had the interest ceiling removed and were able to consider -- subject to their own judgment -- entering this field of mortgage lending, I think you would see probably that the cost of their funds would increase; certainly a percentage of them, because they would be in a position to compete more actively for those funds and in this case I don't think the cost of the funds to them would come probably any more cheaply than they do to a member of the so-called near banks now that are offering mortgage facilities, having in mind that still a large percentage of our funds will be used in commercial and other loans of that nature.

COMMISSIONER LEMAN: If the cost of your funds increased over what it is now, isn't it likely that the

cost of their funds will increase a little over what they are now, if they are the next step up in the ladder in the cost of funds spectrum?

MR. WADSWORTH: Only if they wanted to keep the differential which is presently there in what they are able to pay for funds. I think probably in a period of time the reverse might be the fact, that the cost of funds to the borrower or another important lender in the field might tend to come down to a modest extent.

COMMISSIONER MACKINTOSH: May I ask in this connection -- and this may have been asked before -- aside from the influence of the 6 per cent ceiling, is there likelihood that the banks would still be "in and outers" in the mortgage field and would have to draw back when the demands for commercial loans was high and push ahead when it was low?

MR. WADSWORTH: I think we did try to answer that question yesterday, but I would like to repeat that very briefly today, if I may. We would hope not. We would hope, if we were providing what was looked upon as a good and essential service, that that would be taken into consideration, and we have found in a field such as the National Housing Act mortgages -- and I think it would be more apparent in the conventional mortgage field where the terms are not so long -- that after you have built up the portfolio you would have a cash flow to keep you in the business for quite an extent.

COMMISSIONER LEMAN: I wonder if the banks have sort of become a bottomless well all of a sudden, because having removed the 6 per cent ceiling, having given you the authority to take mortgages, the banks have now moved into new areas of lending where they were less active before, and they hope not to be "in and outers" in these areas, so that the area of lending that the banks service today would get less. There is not an unlimited supply of funds.

MR. WADSWORTH: I would hope that no essential area that the bank services today would get less. As I said in answer to the last question, I would hope that the planning of monetary policy and its effect on the banks -- I feel sure they would be providing a good service to the financial needs of the community and would be provided with resources in order to continue in that field.

MR. MULHOLLAND: It has been the experience that since 1954 the banks have taken on collectively a very large aggregate total of N.H.A. mortgages, up to a billion dollars, and that no area, no borrowing area to my knowledge has been deprived of lending resources.

COMMISSIONER LEMAN: They later moved down in that field.

MR. MACARTHUR: They are not entirely out.

COMMISSIONER LEMAN: They moved out to lending new money.

MR. MACARTHUR: Yes.

MR. WADSWORTH: We would have been back in the field a lot sooner if we had been able to charge the same rates being charged by the central authority or set by the central authority.

MR. NEAPOLE: I think, if I can put something in here, it is safe to say that no bank likes to be an "in and outer" in any kind of thing, and in particular in relation to personal loan plans, N.H.A. mortgages or any particular type of mortgage or loans. I think what we would do would be to try and manage our own affairs so that we could gauge the amount of this business we were going to do as related to the total. Having done that, then we would hope to attract the deposits to be able to do it and try to match it up that way.

COMMISSIONER LEMAN: Perhaps I should have worded my question differently. Let us say they have gone into these new areas of lending in a fairly substantial way, and let us say they don't want to be "in and outers", and they stay in in a fair proportion, as they have gauged it, then can it be assumed that the only other solution is that they have to attract more deposits?

MR. NEAPOLE: Yes.

COMMISSIONER LEMAN: From somewhere, and presumably they would get these deposits away from the other institutions that were servicing these particular markets.

MR. NEAPOLE: I wouldn't say necessarily,

because I have in front of me a table which shows the total obligations to selective financial institutions, which is one of the tables prepared, and from 1947 to 1961 the total of all deposits went from seven billion four up to nineteen billion five, and with the others having gained tremendously as compared with ours. We would just hope that we would get our fair share of the increase, so to speak, from there on to be able to take care of this expansion.

COMMISSIONER LEMAN: This is an attempt or a hope to equalize rates of growth.

MR. NEAPOLE: In a sense, yes.

MR. WADSWORTH: As to how effective it would be, this would be up to ourselves, what we are asking for, that we would be in a position to at least offer competitive rates on both sides.

COMMISSIONER LEMAN: Would you be willing to give us a guess as to the effect that both of these decisions would have on the bank earnings. Have you got some orders of magnitude in mind?

MR. WADSWORTH: Have we what?

COMMISSIONER LEMAN: Do you have some orders of magnitude in mind? Did you when you wrote the submission?

MR. WADSWORTH: When you are referring to earnings, if it is just straight earnings I think it is quite obvious that if the banks could put some of their loanable funds into longer term assets

yielding a higher rate, our earnings obviously would go up. Whether our net operating profit would show a very marked increase or not remains to be seen because, as mentioned by Mr. Neapole and others earlier and myself, we would feel that in order to get into these fields we would have to pay more for deposits, so it is the difference that counts, but your question was earnings and I would say yes, earnings I would expect would go up, but I think the costs of applying the funds would go up, too.

COMMISSIONER LEMAN: You don't make a request in order to reduce earnings!

MR. WADSWORTH: Oh no.

COMMISSIONER LEMAN: I am just asking you if you have any orders of magnitude in mind, if you have done a little figuring on this.

MR. WADSWORTH: Well no -- I would have to ask the individual banks what they may have figured out on this, but I don't think we have done any direct figuring on it because I think in the first place it is an area which we would move into, I think, relatively slowly at first and feeling our way. If it resulted in both sides of our balance sheet increasing, we would hope that the net result would be a better net operating performance, not necessarily percentagewise in relation to assets, but in total dollars, otherwise we wouldn't even be holding our own.

MR. NEAPOLE: I would like to say something. I think one of the things that should be

mentioned is this: In connection with trying to acquire more deposits and become more effective in that area, it is not necessarily to acquire the deposits entirely for these additional types of lending.

Admittedly, the banks are a tremendous organization serving a tremendous amount of country and a tremendous amount of demand. If we are going to continue to fulfill our function and look after this demand properly, then we do have to have this ability to acquire the deposits to do it; they are fundamental to our system.

COMMISSIONER LEMAN: With regard to the 6 per cent ceiling the point does not arise, but with regard to the ability to take mortgage securities a fairly broad question arises as to whether it is better, in any economy, to have strictly non-specialized institutions for serving various sectors of the economy, or if it is not perhaps sometimes better to have some specialized institutions to serve those sectors.

MR. NEAPOLE: Basically, I would say it is necessary at times to have them. I think a lot of these specialized ones do fulfill a very useful function.

MR. BOYLES: In some areas we got some experience over the past several years, and we have become more specialized, and we have engaged people who are specialists and have training in those various fields, and that training is passed on. I would not like you to think the banks are completely unspecialized.

COMMISSIONER LEMAN: Yes, you hire specialists and develop them and train them, but you are not, as it were, becoming more specialized.

MR. BOYLES: I thought that perhaps you meant we were lacking in specialists.

COMMISSIONER LEMAN: You are getting more expert, but not more specialized.

MR. MULHOLLAND: Expertise.

MR. WADSWORTH: There will always be a place for an organization specializing in one certain area, but the growing financial needs of the community are becoming more diversified than they were. We mentioned yesterday -- and I might refer briefly again to it -- this question of not only conventional house mortgages but forms of loans on occasions to small borrowers in the secondary industry field who have not other sources of funds to turn to.

COMMISSIONER LEMAN: I am not suggesting there is any validity to the concept, but I think some people in Canada have thought that the conventional house mortgage field was a fairly specialized field.

COMMISSIONER MACKINTOSH: My recollection is that the loan companies said this was their last ewe lamb, and if anybody took it away from them they would have nothing left.

I would like to ask what is, perhaps, a rather general question. It seems to me that for the past decade or so there has been quite a striking development of specialized near-banking institutions that before the war we did not have. They are a little bit like unit shops that have their own function and specialization. Are these proposals you are putting up turning the banks into a great department store that takes the cream off of these specialized fields and leaves the specialist institutions struggling with the tough remnants? This is just a question in my mind, and I am not quizzing you particularly on it. Is this

a trend?

MR. WADSWORTH: I do not think so, Dr. Mackintosh. To take one area of so-called near-bank competition, I have not the figure, but I am sure Mr. Hebert has, of the number of branches of the Caisse Populaire. It is not one or two isolated units; it has 1500 branches alone.

COMMISSIONER MACKINTOSH: We are not really worrying about them. We had the Caisse Populaire before us and I think they can look after themselves!

MR. WADSWORTH: I would suggest that the other organizations, soundly based and managed, can look after themselves as we feel we can.

MR. MULHOLLAND: In the field of consumer lending, in which the banks have recently engaged, in the last few years, I do not think it can be said we have taken the cream of that business away from the financial institutions who had free rein in that area for many years. I have not heard them complaining of severe losses through being obliged to accept secondary class business.

COMMISSIONER MACKINTOSH: Even in that field, I would take it that most of your consumer loan customers were also your depositers?

MR. MULHOLLAND: Yes.

COMMISSIONER MACKINTOSH: I would guess that quite a number of the finance company customers were scarcely depositers at all. You presumably have the better class of customer passing in front of your teller cages every day of the week?

MR. MULHOLLAND: That is right, sir.

COMMISSIONER MACKINTOSH: In industrial loans, where you cannot work out a satisfactory loan because you cannot take a mortgage, if you take all these people who have good mortgage securities, there is a presumption that the remnants are not quite as good credit risks; at least, they cannot put up as good security. Now, maybe what we need in these fields is more competition. I was just wondering whether this was a continuation of a trend toward more specialized institutions, or toward a big "department house" financial system. I will not go as far as to say a "discount department store"!

MR. WADSWORTH: Is not the basic consideration, Dr. Mackintosh -- and this may sound rather trite -- the public interest rather than the welfare of the banks or the near-banks? If those that are providing this service -- and it is a service that is really needed -- are providing this useful service at a competitive price they will continue to grow and to prosper.

COMMISSIONER LEMAN: Except you have already told us we are not very likely to have many new banks!

MR. WADSWORTH: I was not saying we are not likely to have many new banks. You asked what were the considerations with regard to capital, and I said it would need a branch system, but that would not prevent anybody coming in and starting a bank.

THE CHAIRMAN: There was one complaint that I recall from one of the finance companies that appeared before us, that one of the banks happened to be the

[illegible]

banker for a finance company and the same bank was attracting some of the customers of the finance company, and they thought there was a conflict of interest there and that that should not happen, and that you should be out of their business.

MR. MULHOLLAND: Or vice versa.

MR. WADSWORTH: I just come back to the question of public interest and receiving services at the most competitive price.

COMMISSIONER BROWN: You are saying that you are at a competitive disadvantage and are, therefore, losing your share of the general market.

MR. WADSWORTH: Of deposits.

COMMISSIONER BROWN: Which means the other portions of the market have been increasing at a faster rate because you have all been increasing. In this loss of the portion of the market by the banks -- and it would appear these other institutions were fulfilling a function -- who is getting hurt, other than the banks?

MR. WADSWORTH: I was going to omit the banks for obvious reasons. We think that the more competition there is in a market the more effect that competition has on the price and the price structure, and by banks being more into these areas where they are not now the tendency, over a period of time, should be to reduce the cost to the consumer rather than increase it.

COMMISSIONER BROWN: In all the discussions about getting rid of the 6 per cent ceiling there has been an assumption, I think quite basic, that if this

[illegible] and the price [illegible]

[illegible] of the [illegible]

[illegible]

[illegible] should be

[illegible]

MR. [illegible]: [illegible]

MR. [illegible]: [illegible]

question of public interest and education, generally, in the most constructive manner.

[illegible]: You are having with you [illegible]

[illegible] of the general [illegible].

MR. [illegible]: [illegible].

[illegible]: [illegible]

portion of the [illegible] have been [illegible] a [illegible] because you have [illegible]. [illegible] of the portion of the [illegible] by [illegible] -- and it would [illegible] -- [illegible] getting [illegible]

MR. [illegible]: [illegible]

[illegible]

[illegible]

[illegible]

happens interest rates are going to go up. Is this a fair assumption?

MR. WADSWORTH: No, I would like to say it is not. It might be a fair assumption under certain conditions. The range of rates would be wider, but it would not necessarily follow that rates generally, over a period of time, would go up. It could be in periods of much stringency that rates charged by banks could be more comparable to those charged by others. But in the areas of lending we are not in now, I think the effect over not too long a period would be in the opposite direction.

COMMISSIONER BROWN: You have talked about being able to compete on a better basis for deposits. Presumably, on average, you would be anticipating having more revenues.

MR. WADSWORTH: Yes.

COMMISSIONER BROWN: So on average, presumably, interest rates would be higher for your present customers. Is this in their interest?

MR. WADSWORTH: No. I am saying they might be higher for our deposit customers, but in areas of lending we are not able to get into now the competitive rates we will be able to charge would be somewhat lower than where they now borrow as a whole, whether from a near-bank or any other organization.

COMMISSIONER BROWN: But so far as your present borrowings are concerned, the average would be up?

MR. WADSWORTH: It could be up, such as

during the periods we went through in the summer of 1962, where we would have liked to use the interest rate-price mechanism as more of a control over the total of loans.

COMMISSIONER MACKINTOSH: In other words, it is possible the average to the existing customers would be down, but the average over the banking business might be up because you have added higher-priced customers.

MR. WADSWORTH: Yes, and depending on periods of ease and tightness in loanable funds, I would not say they would not be higher at periods in the future than they have been, but I think, conversely, they would be lower than they are now under different conditions.

COMMISSIONER BROWN: Under the present total of bank assets, where such a large proportion of your liabilities is in the form of notice deposits, on which you are paying interest -- and, presumably, you would have to pay an increased rate of interest on all of those -- I find great difficulty in visualizing other than an increase in present interest rates for your borrowers, on average.

MR. WADSWORTH: I think it would depend on the degree to which we felt we should increase interest rates, the degree of succees that had in attracting new deposits and the employment of those funds.

COMMISSIONER BROWN: I am trying to keep this in the context of the public interest, in which we are all interested.

MR. LORENZO HEBERT: May I say a word? When the banks seek to get authority to go into new fields,

I do not think it is the intention to crowd out all the competitors. What the banks wish to do, so far as we are concerned, is to be able to take care of the needs of some of our customers who naturally look to the banks for some type of services which under the present circumstances we are unable to give. There might not be very many of our customers who would like to get mortgage loans from us, but there are some circumstances in which they could not even get mortgage loans from anybody else, especially in outlying districts, because the loan companies are not there. It is the same thing for all the other authorities we are trying to get. So far as the interest rate is concerned, it is not our intention to raise our interest rate, but to be able to serve some special type of customers -- for instance, consumer borrowers -- that, under the present circumstances, we are unable to serve on account of that ceiling.

, Even at the rate that we have today there might be some that we are unable to serve, and it would be easier, of course, if we did not have that ceiling on which we bump our heads now and again, on which we bumped our heads in 1952 and 1959, if I remember well.

MR. MULHOLLAND: Commissioner Brown, may I add a thought there? I see what your thinking is.

COMMISSIONER BROWN: I am not thinking; I am

just trying to get your thoughts.

MR. MULHOLLAND: We have to lift the cost of borrowing to all borrowers and, therefore, we are raising the cost of the borrowing customer? May I take the example today with a prime rate of 5-3/4 per cent, and refer to the prime rate when it was 4½ per cent? There are many loans. In fact, only prime names were entitled to prime rate at any time. The vast majority of borrowers in the banking system were charged rates between 4-3/4 per cent and 6 per cent, when the prime rate was 4½ per cent. If we apply the same mathematics to the prime rate today you can see that your less desirable loans -- and all banks have many of them -- with a prime rate of 5-3/4 per cent that less class of borrowing could be paying 7¼ per cent. There would be thousands paying interest in between that 5-3/4 and 7¼ per cent, and to that extent they will be paying more but they always have paid more, when the prime rate was lower than it is today. Does that make any sense at all?

COMMISSIONER BROWN: It is very sensible, and it is what I would expect the banks to do.

MR. MULHOLLAND: In the area of 6 and 7¼ per cent, for example, a higher rate on savings would be proper. In other words, to use the language of the Governor of the Bank of Canada, the banks would then be able and willing to pay competitive rates for deposits.

COMMISSIONER BROWN: In this general field of competition, could you give us a picture of just how important you regard the 8 per cent cash reserve

requirement and the 15 per cent liquidity ratio? I think you were asked to bring some figures for this, some sort of calculation. It brings up the whole idea at what percent would you keep your cash if you did not have 8 per cent as a requirement, and in what higher earning assets would you put the liquidity requirements?

MR. MULHOLLAND: I think you will find, Mr. Brown, some difference of opinion between the individual banks as to whether the 8 per cent cash ratio or reserve requirement should be changed or is adequate where it is now, having in mind the remarks you heard yesterday as to dividing the rate between time deposits and notice deposits. We do not have strong views on this matter other than we think it is relatively appropriate at this time, although we think the situation of others who are taking deposits should be looked at too, and we await any final decision as to what might be done in that regard or what might be felt should be done in the public interest in that regard.

As to your other question, as I understood it: where would these funds be employed or, in other words, what is the loss to us in carrying the fund? Is that your question?

COMMISSIONER BROWN: Well, no. I think there is an assumption that you probably keep around 8 per cent anyway?

MR. WADSWORTH: Yes.

COMMISSIONER BROWN: That part does not enter into it, but you do have some comments about the liquid asset ratio.

MR. WADSWORTH: I just want to make sure I have your question properly.

COMMISSIONER BROWN: Do you regard this as having a cost factor competitively?

MR. WADSWORTH: There is no question about

it having a cost factor competitively. Let us deal first with the 8 per cent rate. What would be the effect if that was reduced? I have not worked out a figure for that. If you want to take a one, two, three or four per cent reduction, this can be worked out. It is an arithmetical calculation. There again it would vary even now between banks on the assumption that if banks had, say, extra cash from that source to invest, it would go through their investment portfolios, including loans, and you would have to take the average yield on that bank's total assets and say that it would improve it by whatever the rate happened to be. But there is no question about it, the cost of carrying these reserves vis-a-vis those who are in competition and do not have to carry the reserve, is a competitive factor in their favour.

COMMISSIONER BROWN: We have not discussed the question of the liquid asset ratio, the 15 per cent requirement, in the context of monetary control and monetary policy. You have a recommendation in paragraph 476 which is to the effect that you would not like to see this given legal status, and also that you think that whenever it is used it should be used on a temporary basis only.

In their submission the Bank of Canada makes the point that they consider the minimum liquid asset ratio gives them a firmer control over the extent to which such assets might be liquidated by banks in that they can see the total picture which

might start at, say, 18 per cent, but will not go down below the 15 per cent. Now, there is obviously a difference of opinion here. Would you like to speak to this?

MR. HACKETT: Well, sir, as I understand it this is not a cost matter. It involves the area of monetary techniques.

COMMISSIONER BROWN: Yes. We could have brought it up earlier. We did not know just where to introduce it and we decided to discuss it at this point.

MR. HACKETT: With respect to the 15 per cent liquidity requirement which, as you know, comprises 8 percentage points cash and 7 percentage points secondary reserve, the one as it were on top of the other, I think the first point we would make there, a fundamental one, is that this is not a reserve but rather a requirement.

The significance of that, in our opinion, is that it is the excess liquidity defined in the same terms above the 15 per cent that provides your area for temporary adjustment, except in so far as changes from day to day which still results in the 15 per cent average being maintained and provides a somewhat minor degree of temporary adjustment.

In practical terms, then, I think it is a fair statement that when a bank assesses its liquidity which it really has, it is the excess of what it happens to have over 15 per cent. In other words, if for the sake of argument, a bank is

running at an 18 per cent liquidity ratio, its free liquidity is 3 percentage points. Now, I think this does beg the question whether the ends of monetary control would be any less well served if this, as it were, rigid 7 per cent slice of secondary reserves were lifted out of there, and on top of the 8 per cent you were to place the free reserves in the sense of free liquidity that the banks might wish under any given set of circumstances to retain.

Indeed, sir, and perhaps this is a personal opinion, it can be argued that the ends of monetary control might even be more usefully served because if the liquidity were to diminish in a time of restraint you would be closer down to your cash base than you are now.

I agree that that is an arguable point but I would think we would contend that the ends of monetary control could at least be as well served by the elimination of the 7 per cent secondary requirement and its replacement with such liquid reserves as the bank wished to keep or could keep in the circumstances of the time, that if monetary control were more restrictive liquidity would come down; but it seems a rather uneconomic operation to keep another 7 percentage points of secondary liquidity that one cannot use.

THE CHAIRMAN: We shall take a short recess.

--- Short recess.

MR. HACKETT: Mr. Chairman, before we proceed, I would like, with your permission, to add something to my opening remarks on this point. I do not think that in our brief we specifically recommend the abandonment of the 15 per cent reserve ratio. I think its limitations from the standpoint of monetary policy are perhaps implicit rather than explicit in what we have said.

COMMISSIONER BROWN: I am sorry if I gave the impression that I thought you had said it should be abandoned. I was reading from the brief where you state that giving it legal status is neither necessary or desirable, and further on where you say that it should be withdrawn as soon as more permanent remedies can be applied.

MR. HACKETT: That is true, sir. We are on common ground in that respect. With respect to the matter of legal status I think you wish to make some comments at this time, do you not, Mr. Wadsworth?

MR. WADSWORTH: I do not know if we have had that question. Are we being asked if we wish to see this given legal status?

COMMISSIONER BROWN: You have said you do not, so the question is unnecessary.

MR. WADSWORTH: That is right, we do not. This is an agreement between the banks and the Bank of Canada. I know that all the banks feel free at any time, if economic conditions warrant it, to discuss the matter further with the Governor of the

Bank of Canada, and we would do that.

COMMISSIONER LEMAN: May I interject a question here, Mr. Brown? Earlier Mr. Hackett commented on this in relation to the effectiveness of monetary policy, and I am still not sure that I understand what he said. How is it,if the monetary authority does not know how far down you will run the liquidity reserves when he takes action, that that would not reduce the effectiveness of his action? He does not know how far you are going down.

MR. HACKETT: I think that that, Mr. Leman, begs the question as to whether the minimum would be the difference between what you have now and 15 per cent -- that is, the distance to which you can go -- because when you have reached 15 per cent you are in the same position, for all practical purposes, as if you had nothing left because that is all that is available to you.

COMMISSIONER LEMAN: Yes, but in one set of circumstances suppose the monetary authority observes you holding 18 or 19 per cent liquidity, and he comes to a turning point and says: "Now, I am going to start tightening this". He knows that you have three or four percentage points by which to go down, and no more.

MR. HACKETT: Yes.

COMMISSIONER LEMAN: Now, if there is no minimum and you are still running at 18 or 19 per cent when he comes to that turning point, and he does

not know that you will stop at 15 per cent, I do not see how you can say that both situations are equal from the point of view of his knowing what to do, and how much to do.

MR. HACKETT: Perhaps it was implicit in my answer, sir. I am assuming in a condition of freedom to maintain liquidity that the banks as a group might maintain somewhat less, but what they would maintain would be usable, so you would still have the problem of determining how much of their usable liquidity the banks are going to run down.

COMMISSIONER LEMAN: Yes, but do you think that would be as limited as it would be with the 15 per cent ratio in there, or would there be a wider range?

MR. HACKETT: There might be a somewhat wider area, but I doubt that it would be as wide as it is now. That is a personal view.

COMMISSIONER BROWN: At the moment it is 7 per cent on top of the 8 per cent.

MR. HACKETT: Yes.

COMMISSIONER BROWN: Where would you operate if the 7 per cent were not required? There is a point below which you would not go. It might be 2 per cent for one bank, and it might be 5 per cent for another, but there is a point below which you would not go?

MR. HACKETT: Yes. That would be a matter of judgment for the individual bank.

COMMISSIONER BROWN: The Governor's point

is that he does not know where this really starts to take effect unless there is an agreed ratio.

MR. WADSWORTH: Could I add a point, Mr. Brown. This is not, in my assessment of the situation, our complete liquidity. We have called it, for want of a better word, a liquidity requirement. Whether or not we need a liquidity requirement or a cash requirement of 8 per cent we, the banks, would be carrying another 4 per cent in day-to-day loans, and 5, 6 or 7 per cent in treasury bills. Also, in trying to answer that question, you have to take into consideration that even under existing conditions, let us say, our true reserve is not what is over 15 per cent, but is only in those assets which qualify under the definition. The understanding that we have with the government is that with respect to liquidity reserves we might have Government of Canada bonds maturing in a month which would be just as liquid as some of our treasury bill holdings, which might be for one year. You have to look at the whole picture, and in looking at the whole picture and the composition of a bank's portfolio, the difference would not be very great.

COMMISSIONER BROWN: I am sorry, but I have missed something. You said the difference would not be very great -- the difference between what and what?

MR. WADSWORTH: Between the area Mr. Leman was mentioning -- between the minimum required and what the bank had to dispose of to meet loan demands.

because the loan demand distribution looks as if it is the bank's whole portfolio, and if you were carrying an extra 8 per cent in true reserves in day-to-day loans and treasury bills then in your Government of Canada portfolio you might not have as many maturing Government of Canada obligations which you could use more quickly than treasury bills.

COMMISSIONER BROWN: But the Governor's point is that he looks at those treasury bills and day-to-day loans and sees a point below which they will not go in the banking system.

MR. WADSWORTH: That is true.

COMMISSIONER LEMAN: Short of giving this ratio legal status there is an intermediate step, and that is giving the bank the authority to impose it, to vary it, or ---

MR. WADSWORTH: Are you asking our opinion as to whether we would like the Governor to have that authority?

COMMISSIONER LEMAN: I am asking you to comment on that intermediate step.

MR. WADSWORTH: On whether there should be that intermediate step?

COMMISSIONER LEMAN: Yes. It is now a matter of agreement between the banks.

MR. WADSWORTH: Yes, I would like to comment on that, and others might, too. In the first place I think the proposals made by the Governor have been in a broad sort of area, and in a broad way he has not been specific as to what the details

might be, so I think I would have to reply in a broad sense myself.

It is our view that the present liquidity ratio that we have been talking about, or the liquidity requirement, has worked relatively well. As we have pointed out, we are in a position which enables us to discuss its continuance with the Governor at any time.

As to your direct question, we would have strong reservations about putting the additional power in the hands of the Bank of Canada to bring this about without consultation with the banks -- to bring it about merely by direction and order.

I think that the 15 per cent liquidity requirement is another example of moral suasion. It is an example, as I think you mentioned, Mr. Brown, of the banks and the central bank arriving at an agreement between themselves. Any additional power that the central bank had to impound the liquidity without any period of adjustment -- and we talked earlier about a period of adjustment that we felt was necessary in controlling all lines of credit and to meet the requirements of our customers -- we would, frankly, very, very strenuously resist. The procedure such as we have at present enables the Governor to suggest, and strongly recommend, steps he would like to take, but it also provides those most directly affected in its carrying out and the implications of it, such as the banks, an opportunity to sit down with him and talk over the

implications of it, to take into consideration his views, and to have a chance of placing our views before him.

MR. NEAPOLE: May I say something? I certainly would like to see an area left for co-operation and discussion. I can refer back to what I said before, that when moral suasion came in in its most severe form the original suggestion was 8 per cent in three months, which would have been utterly impossible. After discussion at that time that period was lengthened to six months, and the percentage reduced to seven. I would still like to see that possibility retained.

COMMISSIONER LEMAN: I wanted your views on the record.

DR. McLEOD: Mr. Chairman, if none of the general managers wish to speak further on this subject I would like to comment upon it on behalf of the Toronto-Dominion Bank, if I may do so.

I might say that we started out with accepting the views as expressed in paragraph 476 completely as being, we think, a moderate and fair statement of the case. We think, as Mr. Wadsworth has said, that this is, in effect, an example of moral suasion. On this particular point I might be speaking for the other banks which have gone along with this, because the Bank of Canada said: "This is something that is good for the country in general, and we are asking you to co-operate". This is an area in which, if approached in this way, the banks

do normally co-operate if they feel they possibly can.

Nevertheless, I have to say that we are not convinced that this thing has worked well, or that it should be retained. We certainly feel it should not be made statutory. We feel that in reasonably normal circumstances the Bank of Canada can exercise adequate control over the banking system through the cash ratio without resort to the liquidity ratio. I think the exposition in the brief of how the Bank of Canada can control our position by providing or withdrawing cash is quite good, and completely adequate.

Although we do not put it quite in these words we do say admittedly that there may be market situations over which the Bank of Canada does not, in fact, have control. The reason for that is that it is only in the textbooks that markets are perfect, and sometimes it is not feasible for the Bank of Canada to withdraw cash in adequate volume or at an adequate rate without pretty well disrupting the market. In circumstances like that we are quite prepared to see a departure from the use of the cash ratio as a normal procedure. We accept this. This is part of our responsibility. But, apart from demands like that, we do not think it should be retained for the reasons that are quite moderately put here. If this is continued there is the risk that the ratio will be successively increased with each successive crisis.

If once the exceptional circumstances are over, we feel that the logic of it is -- and this provision should be removed and the Bank of Canada should rely on a cash ratio -- to put the liquidity ratio back into commission again so that it can be used again once it becomes necessary.

Now, I was quite dissappointed in the description of this put forward by the Bank of Canada in its brief, in their submissio No. 3, paragraphs 47 to 50, and it ended with the rather bland statement that in the view of the Bank of Canada the asset ratio is a useful instrument of monetary policy and should be retained.

I would like to, if I may, go back a little earlier. This was introduced, and I think it has been explained this morning, beginning on approximately the 1st of December, 1955, which, by the way, happens to coincide with the day of my joining the Toronto Dominion Bank, and was put completely into effect by the 1st of June, over a period of six months.

Now, as to their first annual reports and thereafter, the Bank of Canada -- I don't have that report in front of me, I am quoting from memory on that; I can tell you the page number, but I will not attempt to do so. They say in words more or less to this effect: that this was introduced because they felt it would/make the response of the banks -- in disposing of their long term assets, adjusting their cash and liquidity position-- make it occur sooner and with greater certainty than would otherwise be the case, and there

were one or two other things in there.

Now, paragraph 47 and 48 repeated in a somewhat different way more or less the same argument that were put very succinctly in about one or two sentences in that earlier report -- I don't think they recount anything of value in the experience in the meantime -- but may I say that since this ratio was introduced it has varied between roughly 15 per cent and roughly 20 per cent. This is a variati[illegible] of approximately 5 per cent .

Mr. Chairman, I just question whether it would have varied any more than that had there been no agreement on ratio. It might have varied over a different range; somebody suggested 20 per cent here as a possible minimum level, but if it varied between 12 and 17 per cent there would have been, I submit, exactly the same -- no more and no less -- cushioning of the effect of monetary policy on these longer term portfolios of the bank.

I think, in other words, that this has not worked well; it is not an advantage. It entails risks of an increasing interference rather than a decreasing one, and it is contrary to the use of the market mechanism which most of us subscribe to, and actually I think we would be better served by removing it.

Now, there is one other point; you were asking about how low would the reserves of the liquidity assets ratio go in the extremity if we didn't have such a thing. Well, I think this is a situation where a reserve such as this is a cushion and is used to give you

a little more time to do something else. In other words, you can never reduce this cushion to zero. You never would, that is not the purpose of it. The purpose is to give you a little more leeway so that you can find other ways -- that is, if you are in a situation where you are really under pressure -- find other ways of adjusting.

Mr. Chairman, I think that is all I have to say at the moment.

MR. MULHOLLAND: May I go on record in a sentence, and speaking as the President of the C.B.A., that we question the wisdom of incorporating in legal form a provision which it might well prove desirable to modify, and possibly at short notice, by agreement between the banks and the Governor and under a set of circumstances which we cannot foresee at the present time.

COMMISSIONER MACKINTOSH: I have just a couple of questions and I will not take long. This matter of relations between the banks and the so-called near-banks; that is, as to ownership and directorate management links between the banks and the other institutions, and not only the banks and the trust companies. Why have these links grown up? I am not sure whether this is covered in the Bank Act by prohibiting banks from engaging in any other business or not, but why have these links grown up and what is the value of them?

MR. MULHOLLAND: If I may comment briefly; these links vary as to the policies of the different

banks in their relations with the trust companies, and in these circumstances naturally this is not a subject on which the Association has any unanimous opinion.

COMMISSIONER MACKINTOSH: I realize that in some cases it is an overlapping directorate and in other cases it is stock ownership. I don't know whether there are any cases in which there is merely a traditional link. What are the advantages of these links? Are there disadvantages in it?

MR. PATON: Possibly I might initiate the discussion on this subject, because undoubtedly each bank has a different relationship, and speaking for ourselves, we have no direct stock share ownership in any trust company; we have a moderate share ownership of a mortgage corporation which fully owns a trust company, and this is relatively a recent acquisition. In our instance there are connections of very long and important standing. We have an interlocking directorate; we have several directors in common.

In so far as the management of the company is concerned, a bank officer acts as vice president of the trust company, but so far as the day-to-day operations of the trust company itself are concerned, we play no part. In so far as links with respect to the significance of the flow of funds -- some such link as that -- there has been no evidence or no flow of funds in that connection; it merely protects what had been a life-long association.

We feel that the goals of this association

are several, but we ourselves have no desire to go into trust company action or trust company business, we feel that they are specialized people in a specialized field which they can handle very competently and we feel there is a mutual advantage in their operation and ours, the advancing of which would prove beneficial to both the bank and the trust company.

COMMISSIONER MACKINTOSH: Does that mean that each channels business for the other to some degree?

MR. PATON: Yes, the direction of business to the other. This has proven to be the case, and I think possibly in the case of others, too. I think that possibly sums up our approach to it. We feel that this is to the benefit of the community at large and in no way detracts from the interests of the general public.

MR. BOYLES: Perhaps what I say may in some respects be repetitious, but it is a fact that the banks are precluded by reason of the Bank Act from performing all types of services, and accordingly it appears that such an association has mutual advantages. In other words, the trust company association provides an immediate service facility as it were; in other words, the arrangement is complementary to one other.

MR. NEAPOLE: I think it is safe to say that ours is one of the oldest traditional ones, our association with the Montreal Trust Company. We do not own a share of their stock, directly or indirectly. We unquestionably send business to one another, because we cannot perform trust company functions and they cannot perform some of the functions that we do, but they definitely compete with us. In fact, they are in the same building, and the saying down there is, "Walk upstairs and lose 1 per cent".

MR. MULHOLLAND: Mr. Chairman, except for that last sentence my view is the same as Mr. Neapole's with respect to the Royal Trust Company. We have a very close directorate relationship, probably of an interlocking nature, to the extent that we have 15 individual directors, but we own no shares of this trust company either directly or indirectly, and never have owned any, and they are fiercely competitive for certain classes of deposits which we badly need in times of stringency.

MR. WADSWORTH: May I add our bank's view on this? We have no influence, direct or indirect, on the management or policies or flow of funds of any trust companies as far as the bank I represent is concerned. Probably I should add, whether or not our views in this respect might change in the future I think would depend to a degree at least on whether or not anything was done on the limitations that are now imposed on the banks

with regard to direct competition; but at the moment we have no influence on management or flow of funds.

COMMISSIONER MACKINTOSH: Do you have some common directors?

MR. WADSWORTH: Yes, we have a few.

COMMISSIONER MACKINTOSH: To what extent do the banks associated with these trust companies use them exclusively?

MR. MULHOLLAND: I should not say that we use any particular trust company exclusively in every area in which we would have mutual business, because we have dealings, as bankers, with many trust companies in Canada, either as a straight banking relationship or we may purchase debentures for our investment portfolio only, and other areas in which we do business with them.

MR. WADSWORTH: May I add one sentence to my last answer, Dr. Mackintosh? We have a few directors on the boards of trust companies -- plural and not one.

MR. BOND: To complete the record, perhaps I had better say that the Mercantile Bank is also in a way associated with the Mercantile Trust Company, but at arms' length. There are no shares owned in the Mercantile Trust Company, and it was set up to carry out services the bank could not perform in Canada; they are in connection with inquiries and business from abroad.

COMMISSIONER MACKINTOSH: You have reminded me, Mr. Bond, of a question I intended to

ask, not about your relationship, but to what extent do trust companies own shares in the banks?

MR. BOND: None at all in the case of ours.

COMMISSIONER MACKINTOSH: No, I assumed that.

MR. NEAPOLE: I do not know myself, in our case. They have a lot of shares registered in nominee companies and nominee names, but I do not know how many they actually hold, or if they do.

COMMISSIONER MACKINTOSH: Some of them have significant holdings.

MR. PATON: The beneficial ownership of these shares might be in doubt, or some of them.

MR. NEAPOLE: I would definitely say it is for clients on nominee registrations; I feel that.

MR. MACARTHUR: The details of the major ones are tabled each year in the House by each bank.

COMMISSIONER LEMAN: Is all this non-ownership of shares in trust companies, directly or indirectly, in deference to the provisions of section 75 (2) (b) of the Bank Act, which prohibits banks from, among other things, engaging in any trade or business? Is that the relationship between all this non-ownership and this section of the act?

The reason I ask you that is that it is the only meaning I could find in the text of

paragraph 389 of the submission, which refers to the fact that both the law and the competitive situation prevent banks from dominating any major sector of the economy.

MR. MULHOLLAND: May I have the reference again?

COMMISSIONER LEMAN: The reference in the Bank Act?

MR. MULHOLLAND: Yes.

COMMISSIONER LEMAN: Section 75 (2) (b).

MR. WADSWORTH: I think the answer in connection with paragraph 389 of the brief is that you could include what is in section 75 (2) (b), but it was written in the broader sense, as far as the influence banks might have in any field of business or industry, as we mention it here.

COMMISSIONER LEMAN: I searched for something else in the act that could have any bearing, and I have been unable to find anything.

MR. WADSWORTH: Such is the bearing in the Act, but as far as the paragraph in our brief is concerned, it was written in the broadest sense, that any control or influence to a major degree that we would have in any business or industry would not necessarily be trust company activity, but it could be anything.

COMMISSIONER LEMAN: How do you interpret that section? Do you interpret it as a prohibition against banks owning trust companies and, in effect, dominating them?

MR. PATON: If I may endeavour to answer that, it is not directly indicated regarding trust companies, but this applies to any field of business. I think the legal interpretation is -- and perhaps Mr. Case can correct me -- that we must not own a majority share in any business.

COMMISSIONER LEMAN: When I said, "owning trust companies," I meant to the point of being able to dominate them.

MR. PATON: This not only applies to trust companies, but to any sphere outside the regular field of banking business which, incidentally, is not too clearly defined in the Bank Act either. I would say that the section referred to is one we are fully conscious of in all our deliberations.

COMMISSIONER BROWN: You brought up the point, Mr. Paton, that this did not apply to just the trust businesses.

MR. PATON: Yes.

COMMISSIONER BROWN: Has there been other business in which the banks have been acquiring a major participation? I know of ROYNAT.

MR. PATON: Not a major participation, but perhaps an important participation, Mr. Brown. I am thinking of the name of the organization which you have just mentioned, and which has been brought up in discussion before. It undoubtedly comes within the requirements of this section of the Bank Act.

COMMISSIONER BROWN: Is this a trend? Are the banks going to acquire more and more of this type of business? Are they going into the retailing business? How about other financial institutions?

MR. PATON: It is rather difficult to answer that in so far as trends are concerned. I do not think it should be considered as a trend that one can see develop unduly. I do not think any one of us could speak for the others in that respect.

COMMISSIONER BROWN: I have another question that reverts back just a little bit in connection with this trust company relationship and the interlocking directorships. Let us suppose that something you recommend were carried out, namely, that the terms of competition between the

banks and the near banks became more equalized. One can visualize that if the banks are given more of the powers held by the near banks, that the near banks might tend to take over some of the fields now held by banks. In that case, just how appropriate would interlocking directorships be between companies that are in fact competing in a wider and wider field? I realize this is a rather difficult question to ask the people so directly invo[illegible]d. At the same time there are some principles involved in this, and if you could give us your views on the basis of principle rather than on the basis of problems as you see them in fact, we would appreciate it.

THE CHAIRMAN: Perhaps you would like to sleep on this?

[illegible]

[illegible]: We shall adjourn until 9.15 tomorrow morning.

--- Adjournment.

Royal Commission on Banking and Finance

THE CANADIAN BANKERS' ASSOCIATION
(Cont'd.)

Hearings held at

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THE ROYAL COMMISSION ON BANKING & FINANCE

ERRATA

VOLUME 62

Page	Line	
8241	30	Delete "of the banks to be", insert "if the banks were"
8242	24	Delete this line and substitute "It does not seem to involve any particular difficulty for"
	28	Delete this line and substitute "there. It is little different from lines of credit of other"
8244	17	"expertise" not "expertese"
8247	10	Delete "chartered banks" and substitute "central bank"
8248	2	before "slight" insert "a"
	8-9	Delete "Of course, this has not yet been developed."
	28-29	Change period to comma after "institution" "Whereas" should be "whereas"
8249	1	"reserves" not "requirements"
	14	Delete "I do not mean to say that" and start a new sentence with "The distinction"
	18	"terms" should be "times"
8250	2	insert "one" after second "and"
	3	"by the others." should read "by the other banks."
	10	"other than" should be "out of the"
	12	"by" should be "with"
	22	"benefit" should be "effect"
8251	19	after "expansion" insert "of"
8252	19	delete "with the"
8265	20-25	Delete these lines and substitute "instances do not get value-dated the day they are made; time is allowed for the clearing of the cheque. I am not completely familiar with the time involved, but there is a system whereby there is some delay involved in value-dating with regard to deposits, whereas in"

E R R A T A (Volume 62 cont'd.)

Page	Line	
8265	29	After "Cambridge" insert a comma and change "University" to"Massachusetts"
	30	"on" should be "at"
8274	4-7	Delete these and substitute "was not that the Quebec institutions -- when you speak of the province of Quebec, I think you are thinking of the Caisses -- that their cheques would be negotiable at par, but whether they could"
8275	7	"inducement" should be "crossing"
8278	13	"a few years ago" should read "two years ago"
	17	"the United States" should read "New York State" (see page 8322)
	23	"United States" should read "state" (see page 8322)
8279	13	"strict" should read "strictly"
8280	30	"doing the" should read "doing a"
8282	17	"on interest-bearing business" should read "on an interest-bearing basis"
	19	"lot of credit business" should read "lot of letter of credit business"
8283	13	"To be useful, this currency" should read "To be useful, such a currency"
	17	"available in the foreign lands" should read "available in foreign hands"
8284	28	"first. Let me first say" should read "Let me first say"
8285	8	"unless we can." should read "unless we can do so."
8286	10	"in one kind of" should read "on time"
	18	"use the" should read "take on"
	19	"Euro-currency" should read "Euro-deposits"
	27	"was" should read "were"
8287	8	"which" should read "do"
	22	"in the sense" should read "in that sense but"

ERRATA (Volume 62 cont'd.)

Page	Line	
8288	9	"for" should read "or"
8291	5	"is another" should read "is just another"
	8	"goes into deposit" should read "goes on deposit"
	10	"Canadian" should read "New York"
	30	"for whatever" should read "in the ordinary"
8292	1	"said" should read "set"
8293	1	"Canadian" should read "U.S."
8295	17	"was" should read "were"
	19	"Bank sold" should read "Bank of Canada sold"
	30	"That is a swap that comes to you" should read "That is what a swap amounts to"
8297	12	"Mr. Griffiths" should read "Mr. Shannon"
8312	8	delete "to", insert "through"
8323	22	"was a constant" should read "were a considerable"
	23	"go" should read "be drawn"
8324	29	"business in the" should read "business and the"
8326	2	"our" should read "the"
8330	30	"position on an" should read "position to compete on an"
8368	19	"in" not "and"
8369	4	should read "long because that raises interest rates"
	8	"caricature" not "characature"
8373	9-10	"the string on the tension" should read "the tension on the string"
	30	before "you are getting" insert "what"
8374	1	after "at" insert "is"

Ottawa, Ontario,
Thursday,
January 17, 1963.

--- At 9:15 A.M. the hearing resumed.

THE CHAIRMAN: I shall call the meeting to order.

COMMISSIONER BROWN: When we left last night, Mr. Mulholland, we had a question hanging in the air. I did not know whether you had decided not to answer it or whether you had any comments to make on it.

MR. MULHOLLAND: Mr. Brown, would you please repeat the question?

THE CHAIRMAN: You must have been sleeping on it.

COMMISSIONER BROWN: I will not undertake to repeat it word for word but the main point, I think, was that if further competition is developed in the banking industry, let us call it that for the want of a better word for a moment, so that some of the near-banks, including trust companies in that category, are able to carry out the same sort of operations and functions that the chartered banks do at present, and similarly the chartered banks are given the wider privileges that you have been requesting, so that there will be more direct competition between what are now known as the chartered banks and what constitute the near-banks, how appropriate would it be to have interlocking directorships?

MR. MULHOLLAND: Mr. Brown, I do not think there would be any conflict of interest. In those . . .

circumstances, in my opinion, it would still be appropriate to have interlocking directorships. There will be stiff competition for similar types of business as between trust companies and chartered banks. But that is, first of all, a management problem and in that respect the responsibilities or even indeed the interests of directors may be somewhat academic.

COMMISSIONER LEMAN: May I suggest something, Mr. Mulholland? Were you finish with your answer?

MR. MULHOLLAND: Yes.

COMMISSIONER LEMAN: What we really would like to get at here is for us all to take a good look at section 75 of the Bank Act. There are certain prohibitions in there and you have referred to these prohibitions in your submission and have implied these prohibitions really have some bite in them and that they will produce a certain result which you have referred to.

These prohibitions are referred to in the subsections to section 75. There is a prohibition against engaging in any trade or business, and the main part of subsection (2) says "directly or indirectly." So that it is a prohibition against engaging in any trade or business, and the second one is a prohibition against acquiring the capital stock of any other bank, of that bank itself or any other bank directly or indirectly.

So, we were just wondering how you interpret these sections, what their purpose really is and whether indirectly they can be circumvented or should be circumvented. That is really the point.

If it is admitted that near-banks get into

a line of business which is extremely close to the chartered banks by acquiring stock in a near-bank or, in effect, controlling it through interlocking directorships, etcetera, and if a bank in effect controls the actions of a near-bank, is the spirit of the section circumvented? That is the whole point.

MR. MULHOLLAND: Mr. Leman, that approaches a legal point which I am not qualified to discuss, but my own view is --

COMMISSIONER LEMAN: Well, Mr. Mulholland, if you do not mind I do not believe we should discuss in a leagalistic manner whether this is a prohibition. Let us talk about the spirit of it. What is it intended to do? That is all. What should it do in practice?

MR. MULHOLLAND: If I put it this way, Mr. Leman, does it answer your thought? In my opinion, a bank should not do something indirectly which it is not allowed to do directly.

COMMISSIONER LEMAN: You see, we want to discuss the principles here. In New York state, for instance, you have bank and trust companies. The banks have trust departments and handle the trust business, and similarly a company could apply for a charter and become a chartered bank if it wanted to. Would it be better to allow the banks to have trust divisions and let them do trust business and let the trust companies do banking business if they desire to?

MR. MULHOLLAND: I would certainly not want to go on record that the trust companies or any other companies engaged in business should be prohibited from

going into any other class of business. I follow through with that by saying that in my opinion the banks should have permissive legislation to go into other related classes of business, which would include certain kinds of trust company operations, to be specific in that area.

COMMISSIONER LEMAN: I do not want to speak for the other commissioners but that is the level on which I would like to discuss this. I do not think we should consider legalistic interpretations, for we are here to consider whether the Act is adequate as it is or whether it should be changed, etcetera. So there is no point in discussing anything but the spirit of these sections.

MR. NEAPOLE: Mr. Chairman, may I answer that question from my own standpoint?

THE CHAIRMAN: Yes.

MR. NEAPOLE: As far as our bank's relationship with the Montreal Trust Company is concerned, it does not conflict with this section of the Act in any sense, either in the spirit or in the letter.

COMMISSIONER LEMAN: What do you believe the intent of these prohibitions was?

MR. NEAPOLE: I think it is quite clear that the intent was that we should restrict ourselves to what you would call the normal banking functions.

MR. LORENZO HEBERT: May I interject a word: I think the history of this section is the following. At the very beginning when the banks were just starting their business there was a tendency for them to go into

commercial ventures, either openly or through some mechanism. This represented one big fault on the part of the banks at the beginning of the last century. You may recall that I mentioned land speculation yesterday. This was one example of going into commercial venture. This is the reason why this section was put in the Bank Act in the last century so far as engaging directly in other enterprises is concerned. That is, of course, dealing with the spirit of the law.

COMMISSIONER LEMAN: What kind of enterprises?

MR. LORENZO HEBERT: The law does not say, of course, but historically in the last century banks in the United States and some of them in Canada were inclined to branch out into all kinds of enterprises, in foreign trade, for instance, and capital was very scarce in those days and the banks had their note issue and they were the only ones that could collect savings, and there was a natural temptation on their part to branch out into enterprises that were of a speculative nature.

COMMISSIONER LEMAN: The Act as it stands envisages a certain rather precise type of enterprise that should be a bank. The Act describes what the banking business is or should be. As you read it, as it stands in the Act now, the intent seems to be that that should be your business and nothing else.

MR. LORENZO HEBERT: Yes.

MR. BOYLES: Mr. Leman, I think that the banks are very careful to observe the intent here, and I know of no case where the intent is not being observed. If

there is any activity which suggests that it may be in opposition to the intent, the bank is quick to seek a legal opinion to see that it is indeed operating within the limits of the Act.

MR. MULHOLLAND: Mr. Leman, one could place a very broad interpretation on section 75(e) of the Act as it reads. It provides that the bank may engage in and carry on such business generally -- which is the widest word in the Englis language -- as appertains to the business of banking.

That has never been properly interpreted, and that is why it is so difficult and almost impossible for bankers in this country, or in any other country in the world to give anybody a definition as to what is a bank.

THE CHAIRMAN: Or of the business of banking?

MR. MULHOLLAND: Yes, or of the business of banking, sir.

COMMISSIONER BROWN: Perhaps you could tell us what you consider to be the business of banking?

MR. MULHOLLAND: That is the one question I have been fearing all week.

COMMISSIONER BROWN: Then you must have the answer ready.

MR. MULHOLLAND: We tried to define it, Mr. Brown, in our brief. It starts at paragraph 28 and continues through to paragraph 30.

COMMISSIONER BROWN: Perhaps we should con ine it a little more. What are the banking functions in which you conceive that the near-banks are competing

so successfully with you?

MR. MULHOLLAND: The functions in which the near-banks are competing successfully?

COMMISSIONER BROWN: Yes.

MR. MULHOLLAND: It is in the area of deposits.

COMMISSIONER BROWN: You mean just in the area of accepting deposits?

MR. MULHOLLAND: And in loans too, Mr. Brown. They are able and willing to pay more for deposits and therefore they compete very successfully against the chartered banks.

COMMISSIONER MacKEEN: Mr. Mulholland, there has been a good deal of discussion on interlocking directorates. In your opinion, does it not very frequently happen that a man slated to join the Board of Directors of a bank may be a director of a trust company, or vice versa, and it is simply because he may have such qualities and experience and contacts that he is a desirable person to serve on the boards of both the trust company and the bank rather than the fact that being a director of a bank he is invited to be a director of a trust company just for that reason?

MR. MULHOLLAND: Very importantly so.

COMMISSIONER MacKEEN: Do you see any advantage in precluding a trust company director, for instance, from joining a bank, or vice versa?

MR. MULHOLLAND: Definitely not, Mr. MacKeen. Directors of banks are men of the broadest experience in every business activity in the country, and it would be wrong of the banks to be obliged to exclude individuals

[illegible]

just because they happen to be directors of a trust company.

COMMISSIONER BROWN: I should like to go on now to discuss the question of this competition of and by near-banks. First of all, we might refer to paragraph 32/which you refer to the fact that the near-banks hold their liquid assets in the chartered banks, and that just as the central bank is the lender of last resort for the commercial banking system, the commercial banks in turn can perform the function of lender of last resort to the near-banks. You finish up with the sentence:

> "The liquidity of the entire financial structure depends largely on the liquidity of the banks."

Do you see problems in this for monetary control? Is this a dangerous situation as far as the banks are concerned?

DR. McLEOD: Mr. Chairman, and Mr. President, if I may answer that: no, this was not particularly from that point of view. It was primarily an attempt to draw attention to this as one of the key roles that the banking system plays in the financial structure. It does not seem to have any particular difficulty for solvency; indeed, on the contrary the type of assets of these institutions is such that they are generally very creditworthy and there is no particular question there. It is different from lines of credit of other institutions which may be called upon under certain conditions, and as far as monetary policy is concerned

that is not particularly the aspect of it that causes trouble. It is not their access to bank loans particularly, for they normally finance through their internal cash flows and through the ability to attract funds from other owners of deposits.

COMMISSIONER BROWN: In order that you might compete more effectively you have suggested that the 6 per cent ceiling on your rates be removed and you be given the opportunity to lend o. security of mortgages. We have mentioned several times that this implies the corollary: you would be prepared to see these other people into whose field you would be entering get some banking privilege sections such as sections 82, 86 and 88.

What I would like to know is just which of the near-banks are you worried about? Which of the near-banks are you wanting to be able to compete more effectively with, and therefore with whom you are prepared to compete?

MR. LORENZO HEBERT: Well, I would say all of them.

COMMISSIONER BROWN: All right. Let us list them.

MR. LORENZO HEBERT: I think they are listed here: trust companies, loan companies, credit unions, the Caisse Populaires.

COMMISSIONER BROWN: How about finance companies?

MR. LORENZO HEBERT: Finance companies. What I meant by compete is to be in a position, of course,

to handle all business that is offered to us, and that would come within the concept of banking. There are some marginal cases and it is those marginal cases that sometimes are a handicap to the banks because the Bank Act, of course, is so strict. We are the only institutions that are guided by a law as specific as the Bank Act.

COMMISSIONER BROWN: Is it correct to say that you would be prepared to se them similarly enabled to compete in all the things that you now do?

MR. MULHOLLAND: I would give the answer "yes" to that, Mr. Brown.

COMMISSIONER MACKINTOSH: Without coming within the provisions of the Bank Act?

MR. MULHOLLAND: No.

MR. LORENZO HEBERT: That is provided they are subject to the same regulations, that they are under the same handicaps as we are in some things.

COMMISSIONER BROWN: I would just like to ask Mr. Mulholland what he meant by "no" -- that you would not like to see them come under the Bank Act or that you would like to see them come under the Bank Act?

MR. MULHOLLAND: May I put it this way, Mr. Brown, that perhaps they should be subject to restrictions appropriate to the kind of business they are doing or want to do.

COMMISSIONER BROWN: What would you think of the idea of an omnibus act, say called a Financial Institutions Act, which would include banks and some of these others which would really be called banks, all under the same act, and all given the privilege of calling themselves banks? They are all going to be carrying out a banking function.

COMMISSIONER LEMAN: Do not invoke the constitution in your answer, now! That is considered unfair to the Commissioners.

MR. NEAPOLE: Mr. Chairman, might I say that from my viewpoint I would have no objection to having them operating exactly the same as we do, under the same regulations, performing the same functions; I would have no objection.

COMMISSIONER BROWN: How about the reaction of other general managers?

MR. PATON: Mr. Brown, I think essentially we have to remember that any depository engaging in the business of attracting funds has a very serious and strong responsibility to the owners of these funds, and any legislation that might be widened to include the near-banks, if it were made too wide, might involve a serious difficulty in assuring that trust is properly observed. Therefore,

before making any type of omnibus act such as the one you have referred to, it would have to be very carefully considered, to make sure the prohibitions that are in it are sufficient to protect the depositors' money.

COMMISSIONER BROWN: I think that is understood. We are discussing this purely on a hypothetical basis at the moment, and we are not trying to draft legislation. If you want to be able to compete with the others, presumably you have to see them all competing with you.

MR. PATON: This I would agree to. We feel it is not by any means a one-way street, and I think legislation should be enacted which would permit a widening of the participants in what we refer to as the banking field. The word "expertese" was used considerably last week, and I think it has a strong connotation, [illegible] sir, with regard to banking, and the ability to take sections 82 and 88 could well be attractive to all competitors, but this takes a considerable amount of care to make sure this is properly taken. I think you will find a good deal of reluctance on the part of the competing institutions to even come under such legislation.

COMMISSIONER BROWN: Presumably this would be their choice or decision.

MR. PATON: I cannot speak for them.

COMMISSIONER BROWN: Somebody did suggest that if they are so successful in attracting some

of your depositors they might attract some of your staff.

MR. PATON: We might not fight them too hard on that!

MR. WADSWORTH: I would concur broadly with that view, Mr. Brown. If, in the opinion of the Commission, they were performing banking functions, they should come under the banking regulations. We have no wish to curtail competition in that regard whatever.

MR. BOYLES: These so-called near-banks appear to have no restrictions with respect to powers such as those imposed by the Bank Act on the chartered banks. If we are to suggest that the banks be accorded similar treatment, I suggest the banks should be freed from the very restrictions we are talking about, and, similarly, the other institutions should be subject to the same restrictions and reserve requirements generally.

COMMISSIONER BROWN: Including the 8 per cent and 15 per cent, or some sort of cash reserve requirement?

MR. BOYLES: Yes. That is one of the major elements of competition, that they are freed from that particular cost.

COMMISSIONER BROWN: We asked you yesterday if you had any estimate of this, and it appeared that it was thought the 8 per cent was a fair cash ratio.

MR. BOYLES: Yes.

COMMISSIONER BROWN: But there were some differences of opinion about the secondary reserves.

MR. BOYLES: Yes.

COMMISSIONER BROWN: Would you express an opinion, if reserve requirements were made for these competing institutions, should they be held in the Bank of Canada or should they be held in the chartered banks, as the Qu[illegible] Savings Banks now have the option? This comes down to a discussion of monetary control, and if it is a question of cost -- I mean, relative interest-rate cost -- then monetary control is unaffected, whether their deposits are in the banking system or in the Bank of Canada. If it is a question of availability, I suppose they should be in the Bank of Canada.

MR. MULHOLLAND: To have effective control, those deposits should be in the Bank of Canada.

MR. LORENZO HEBERT: May I suggest, in the case of quite a number of them, it would be more convenient to have them in the chartered banks, because some are in outlying districts where their dealings with the Bank of Canada might not be so convenient.

MR. BOYLES: There may be other reasons why such deposits should be lodged with the chartered banks. In many cases, they will continue to be the clients of chartered banks which will provide clearing arrangements and other ancillary services,

and the balances would help the banks for these costs.

COMMISSIONER BROWN: If somebody is trying to read something into the fact I have brought this subject up, I emphasize that no decisions have been made, and we are merely trying to get some ideas and opinions.

MR. WADSWORTH: To be really effective, in the broad sense, and it is acknowledged they are providing banking services, their reserves should be carried with the chartered banks.

DR. McLEOD: May I add a word from the economist's point of view -- and, as I pointed out before, I am speaking primarily from the technical point of view. I think there is quite an important matter of principle involved here that has not yet been adequately put forward in the evidence, that the effective reserves that are held as the chartered banks now hold them with the Bank of Canada are quite different from the reserves held by near-banks with the chartered banks, even though in terms of the cost differential it would appear to be the same. For this reason, the Bank of Canada has almost precise control over the amount of cash reserves available to the banks. In technical, economic terminology, the supply of these reserves to the banks is almost completely inelastic. If the Bank of Canada decides to put them at such-and-such a level there is virtually nothing we can do to expand them. With respect to reserves of near-banks held with chartered banks, it is quite the con-

trary. Their supply of funds is elastic, and in terms of slight sacrifice to some other resources -- and perhaps I am a little cavalier in saying "slight" but slight in relative terms -- they can add to their cash requirements, and the monetary authorities could have only a limited ability to restrict that, and they would have to put very severe pressure on interest rates generally. Of course, this has not yet been developed.

COMMISSIONER MACKINTOSH: I can see that a trust company can attract deposits. Can they attract deposits from other than banks and other than depositors who are within the banking system, or do these deposits just not move around?

DR. McLEOD: Yes, Dr. Mackintosh, they can attract them. Perhaps I should be a little more explicit. I do not mean in the sense of offering a little more for deposits and getting more people to move their deposits to trust companies. But supposing a trust company, or any other depository, finds itself pressed for cash, or with an opportunity to make loans in times of tight money, in the situation the bank finds itself in, it could, by sacrificing some of its bonds or other assets, acquire command over bank deposits previously held by other people, and this is part of the increasing velocity of circulation of money. This would not diminish the cash available to any other institution. Whereas, if an individual chartered bank attempted to do this the only way it could increase its cash

requirements would be by depleting those of some other bank, and that other bank would be forced to proceed to the same expedient. You would have a deflationary pressure on the assets and liabilities of the banking system, and there would not be any such comparable pressure on the assets and liabilities of the near-banking system.

COMMISSIONER MACKINTOSH: I can see that there is more stretch in the control, but I cannot see that it is absent. They are all operating ultimately on the Bank's cash reserve, as far as liquidity is concerned.

DR. McLEOD: That is right, Dr. Mackintosh. I do not mean to say that the distinction is that the pressure on them is indirectly through the interest rate and not directly through the availability of cash reserves. This might be quite a significant difference in terms of tight money. If we offered 25 per cent interest on additional cash of the Bank of Canada, I do not think that would persuade the Bank of Canada.

COMMISSIONER MACKINTOSH: Who do you mean by "we"?

DR. McLEOD: An individual chartered bank, or the chartered banks as a group.

COMMISSIONER MACKINTOSH: An individual chartered bank would do pretty well for a while if it offered 25 per cent, but I do not know for how long. It is the system as a whole that cannot do this.

DR. McLEOD: Of course, this is a purely hypothetical and, indeed, fantastic proposal, and that would have to be matched by the others.

COMMISSIONER MACKINTOSH: If the banking system, by the removal of ceilings, was put in an equal position with the trust companies to attempt to attract deposits back and forth, is there more than what you would call slippage?

DR. McLEOD: Attracting deposits back to the banking system other than near-banks would not affect the cash reserves of the banks held by the Bank of Canada. In exactly the same way with a given money supply, the near-banks can, in fact, expand their loans and investments without affecting, one way or another, the assets and liabilities of the chartered banks, other than who holds the deposits. It is the passing around of these deposits that causes the chain of reactions that brings about these results. Reversing this in like way would deflate the near-banks in that sense, and if the chartered banks were able to do it, that would not have any immediate benefit on the cash position of the banks.

COMMISSIONER MACKINTOSH: I find it easier to think of it in terms of additional slippage in the system.

COMMISSIONER BROWN: I think we should point out, Dr. McLeod, that the Governor of the Bank of Canada, in his evidence, several times reiterated that they were more interested in credit conditions

than the cash in the system.

DR. McLEOD: I think that is a perfectly correct statement, if I may say so.

COMMISSIONER BROWN: Under those circumstances, does your assumption about a constant supply of cash mean much?

DR. McLEOD: A constant supply of cash to whom, sir?

COMMISSIONER BROWN: To the banking system.

DR. McLEOD: A constant supply of cash to the banking system determines, within very narrow limits, the exact size of the assets and liabilities of the banks.

COMMISSIONER BROWN: If the central bank had a credit condition objective?

DR. McLEOD: The influence of that is, if you had a given level of activity or, perhaps, if you want to see a given rate of expansion activity through increased bank credit and loans available from the banks, with, say, as a hypothetical example, there being no increase in the assets or liabilities of the near-banks, and then you introduced some feature which permitted, on top of that rate of expansion, a further expansion by the near banks, then the Bank of Canada would have to take that new expansion by the near-banks into account, and would have to reduce the amount of reserves or new reserves being made available to the banking system, so the rate of expansion of the banking system

would be decreased by the amount that was occurring outside. That is what I mean by saying that the Bank of Canada must take account of the total credit situation and not just the money supply or bank credit.

COMMISSIONER BROWN: But if they are looking at the credit situation as a whole, rather than the money supply and bank credit, what is then the difference, or is there as much difference as you would make out on your premise?

DR. McLEOD: Yes, Mr. Brown, I think this precisely means the banks would be the residual suppliers of credit to the community. If other credit-granters provided more credit -- and I suppose we are implicitly assuming here this is the maximum amount that can be allowed for external reasons, presumably, and more would create inflationary pressures -- if this is the maximum amount that can be permitted and the near-banks get in there with the "fastest and mostest", we have to take what is left.

COMMISSIONER BROWN: This is on a price differential, and this would have to be equated for everybody.

DR. McLEOD: That is the reason why they would be able to attract the resources with which to operate. That is true, sir.

COMMISSIONER MACKINTOSH: If I could be so presumptuous as to interpret the Bank of Canada, I am sure they mean nothing else by "general credit conditions" than that the supply

of money, as such, is relatively meaningless unless you take it in relation to a given set of credit conditions or a set which the central bank desires to create. It is not the money supply or the credit conditions, but it is the money supply in relation to a given set of credit conditions. They are interested in establishing a money supply which is appropriate to the set of conditions they think is desirable, but they are not looking at one or the other; they are looking at both.

COMMISSIONER BROWN: Let us not debate among ourselves here, sir!

COMMISSIONER LEMAN: Mr. Chairman, I would like to turn to a different subject, but one fairly closely related to what we have just been talking about. The Association has put before us a very good appendix describing the payments and clearing system in use in Canada. There has been criticism before this Commission -- I have no need to say from whom--about the manner in which the clearing system is organized, and there have been suggestions for changes. As I understand it, the clearing system now is operated by the Canadian Bankers' Association under the act governing that Association. Are there any members of the central clearing now other than the chartered banks?

MR. LORENZO HEBERT: Yes. There are the two Quebec savings banks, and there is the third member, The Bank of Canada. In Montreal it is the City and District Savings Bank, and in Quebec it is the Quebec Savings Bank.

COMMISSIONER LEMAN: What would be the conditions for admitting other members into it?

MR. LORENZO HEBERT: I think all conditions are pretty well outlined in our rief. I would refer you to paragraphs 410 and 411.

COMMISSIONER LEMAN: I do not see there the conditions for admitting the near-banks into the central clearing house. These are conditions under which you feel they should organize their clearing before it gets to the central clearing house.

MR. LORENZO HEBERT: But these are the conditions that apply now to those who use the bank's facilities for clearing. These conditions apply now, and as a matter of fact, they have applied for a number years.

COMMISSIONER LEMAN: But you have never specified the conditions under which they would be admitted as members of the clearing house, if they wished to become members. Is there any possibility of their becoming members if they want to, and what would be the conditions?

MR. LORENZO HEBERT: The clearing houses form one part of the clearing system. The clearing system is one function that the bank can perform very efficiently, because of its large network of branches. The banks have

arrangements between themselves to facilitate the clearing of cheques from one bank to another, and from one branch to another. There are only 51 clearing houses in the whole of Canada. There is just one special mechanism in large centres where there are a number of banks, to facilitate the handling of cheques.

COMMISSIONER LEMAN: I am wondering if you have answered my question. Are there specified conditions under which near-banks could become members of the clearing house?

MR. LORENZO HEBERT: I don't think we have been requested to give out a set of conditions under which they would be admitted, and so far as I know we have not yet considered making out a set of specific conditions under which they would be admitted.

COMMISSIONER LEMAN: No near-bank has ever applied for membership, or has ever asked either formally or informally for admission?

MR. LORENZO HEBERT: Not to my knowledge.

COMMISSIONER LEMAN: What would be the objections to having a system under which some kind of neutral organization, which would admit near-banks as members of a central clearing system? To which everybody would contribute his fair share?

MR. MULHOLLAND: May I interject an answer to that question, Mr. Leman?

Briefly, the main objections to having an outside organization operate the clearing house system is that -- and this is the most important objection as I see it -- it would jeopardize the very confidential

nature of the transactions as between a bank and its customers and interbank.. That is to say, a third party would have very important knowledge of large transactions going through the clearing system which they should not have. I am referring, of course, to large entries. By observing these entries certain transactions would be made abundantly clear to a third party. A third party intervening in the clearing system would definitely break down that most confidential nature as between a bank and its customers, and between banks.

COMMISSIONER LEMAN: Suppose that third party would be the Bank of Canada?

MR. MULHOLLAND: I would consider the Bank of Canada in this respect very definitely to be a third party. The information on large transactions, when seen by the Bank of Canada, would give them information which they do not now get and cannot get. A large cheque signed by A payable to B might reveal certain information to the Bank of Canada which would be most undesirable from the customer's point of view.

COMMISSIONER LEMAN: How did the Americans get around this objection?

MR. MULHOLLAND: It may be that the control of the clearing system is broken down into smaller units. I am not referring to the unit system of banking, but to the federal reserve areas. Whether information would be available from one area to another, I don't know. Mr. Leman, I really can't possibly answer that question.

MR. BOYLES: Mr. Leman, perhaps I am not

going directly to your question, but as you well know the Canadian Bankers' Association Act confers powers upon the Association to establish in any place in Canada a clearing house for banks, and to make rules and regulations. In fact, all banks, whether members of the Association or not, have an equal vote in this matter.

Now, there is nothing in the rules and regulations or in the Act which precludes someone else from making application for membership; but in practice this has not been done, except in two or three cases as described by Mr. Hebert. If applications were made, I would think they would be considered in the light of their respective merits.

COMMISSIONER LEMAN: To continue with the discussion initiated by Mr. Mulholland, do you not think it would be possible to get around all the objections you have mentioned by making sure that the person at the top would be a neutral party, not interested in the information in any way?

MR. MULHOLLAND: I would like to go back if I may, by way of a partial answer to your question and to supplement a previous comment I made.

You suggested that the Bank of Canada might be responsible for the clearing system. The speed with which, under today's banking conditions, we must transmit items across the country and as between banks, particularly in the larger centres where there are heavier volumes of clearings, I could visualize the situation where, if the Bank of Canada was charged with this

responsibility, with all banks clearing their cheques to the central bank in the morning, the drawee banks might not receive their cheques until 24 hours later, which would be a very serious delay in the clearing process.

COMMISSIONER LEMAN: I am not sufficiently informed technically with the way the system would have to work. Would this necessarily follow that there would be this delay, or is this just a danger?

MR. MULHOLLAND: It is the danger.

MR. LORENZO HEBERT: May I add a comment. The banks last year cleared among themselves one billion cheques; the near-banks, as you will see, had only thirteen million cheques.

The banks are satisfied with the system they now have. We find that we can handle these cheques between ourselves very efficiently, and we think that to turn the bulk of our cheques over to another institution just to take care of thirteen million cheques would mean an added cost to the banks and would make our whole clearing system, as has emerged during this past century, much less efficient than it now is.

MR. HARRIS: Mr. Chairman, it might be useful if one were to attempt to give a definition of what is called the clearing system. Without consultation, I would define it as the sum total of all branches of chartered banks, plus the two Quebec banks named by Mr. Hebert, plus the Bank of Canada - and that is all. The clearing house as such performs a very insignificant function. Frankly, I cannot quite see what another

organization imposed on the chartered banks could do or what function it could possibly perform. I would say that during the past year probably not one cheque passed through a clearing house. The physical exchange of cheques takes place possibly on the day the cheques are received or before the clearing house meets in the morning. The meeting of the clearing house is a very gentlemanly affair, where the clerks advise the clearing house manager what each bank owes the other.

COMMISSIONER LEMAN: Mr. Harris, I am wondering if your comment is consistent with the one Mr. Hebert made. If the clearing house function as such is rather an insignificant part of the total, it is because of the tremendous amount of clearing that takes place within the bank before the items ever get to the top of the pyramid.

MR. HARRIS: That is right.

COMMISSIONER LEMAN: In that case, if other institutions that wanted to pay to clear at the central point were performing the necessary underlying function in order to keep the clearing house function rather insignificant, it does not seem to me that the two comments are consistent.

MR. HARRIS: Of course, the chartered banks were in existence some hundred years before the near-banks, and the instruments with which they have been dealing are the instruments covered by the Bills of Exchange Act. Subsequently, there has been the development of the near-bank system, and of course the instruments they issue are not covered by the Bills

of Exchange Act, and the banks refer to them as "orders".

In my judgment, when a near-bank comes to a bank and asks for the privilege of clearing its items through the banks, then it comes in as any other customer of the system and pays.

MR. WADSWORTH: May I add another remark, Mr. Chairman? Is not another important consideration that of having in mind what has just been said, that banks exchange cheques between themselves, and the clearing house is now more of a settlement point. When these near-banks speak of being members of the clearing house, it automatically follows that if we are going to make proper settlement they would have to have accounts with the Bank of Canada. Are they talking about future conditions or present conditions?

COMMISSIONER LEMAN: I admit this is possible, but there would be no difficulty about having them keep clearing accounts with the Bank of Canada.

Are the banks in a position to give us a rough idea of the cost relative to the charges they make to the non-bank members for the clearing services? The banks have made reference to the fact that there was a cost involved in handling the instruments of other institutions, and they do make charges for this. How does this all balance out?

MR. LORENZO HEBERT: We charge them five cents for each order cleared for them, and our studies show the fact that this is even below our actual cost of handling each item.

MR. BOYLES: Mr. Leman, there is a schedule

of charges as it relates directly to, let us say, their access to the clearing house. I think we could table that with you.

COMMISSIONER LEMAN: I understand, Mr. Boyles, that there is a schedule of charges and the banks as a group stand the costs of the clearing system. But this thing must net out someway. Can you give us any idea as to how it nets out?

MR. WADSWORTH: May I make another comment? My understanding is that we have already submitted to the Royal Commission, through its secretary, the details of the charges, the cost involved, and the net cost to the bank, all in some detail and under various headings. I think you have the detailed information to that effect on file.

COMMISSIONER LEMAN: I have not seen the details, and I am not asking you to put the details on the record here today. I am just asking to give us a rough idea of it. Is it a loss proposition?

MR. WADSWORTH: It is definitely a loss proposition.

COMMISSIONER LEMAN: There has been an expression of some dissatisfaction over the fact that these other institutions do not know exactly how the cost and the charge are related; that is the only reason I raised the point.

In the appendix which I referred to earlier, paragraph 5 thereof, I would like to quote the sentence which reads:

> "Within the banking system, the difference in approach between the two countries ..."

You are talking about England and Canada there:

> "-- lies in the clearing process, in that the English system is based on credit transfer while the Canadian system relies on the principle of debit clearings."

Would you elaborate on that just a little bit to explain the significance of this contrast?

MR. LORENZO HEBERT: We here in Canada use cheques on 98 per cent of our transactions while in Europe they have the Giro system. Instead of the debtor sending a cheque to his creditor, which is deposited in the bank of the creditor and comes back to the debtor's bank to be debited to his account, the debtor instructs his bank to remit to another bank for the account of so and so, which is the system which is, of course, widespread in Europe and which to some extent has been coming

into use in England lately.

COMMISSIONER LEMAN: What are the relative merits of the two systems?

MR. LORENZO HEBERT: Well, there are advantages, of course, to both systems, depending on the circumstances. The conditions here in Canada are altogether different from what they are in Europe. Our people have been used to the cheque system where they don't have to do anything. If they owe some supplier or anybody else, all they have to do is write a cheque and drop it in the mail, while under the Giro system you have to go to an office, fill out a form and indicate exactly the name of the institution where the account is carried. People are used to that in Europe, but we are not used to it and personally I don't see how it will ever catch the fancy of our customers.

COMMISSIONER LEMAN: I suppose that the Gyro system may lead to the possibility of some errors; the debtor giving the wrong address for his creditor, and that sort of thing?

MR. LORENZO HEBERT: Yes indeed, that is why in Europe -- in France or the Netherlands -- each of these accounts have a specific number, and when you fill out the form when you want to make the payments you have to indicate exactly the number of the account and the institution where it is carried.

COMMISSIONER LEMAN: I wonder if one of the consequences of the different system we use in Canada has led to the general practice of having

creditors charged with any costs involved in the payment through the banking system, whereas under the Giro system obviously, if there are any costs to be charged, they would be charged to the debtor.

MR. LORENZO HEBERT: That is the case, sir.

COMMISSIONER LEMAN: What are the relative advantages and what is the relative logic of charging the creditor rather than the debtor?

MR. LORENZO HEBERT: Well, I think that as in any other institution the logic is not always the main -- it is a question of how these institutions do it, how they are related to all kinds of methods, and here in Canada and in America in the last century it has been the practice to send a cheque and the bank who receives the cheque will have to collect the money and it makes a charge for that.

COMMISSIONER LEMAN: But isn't it true that in this country the overwhelming majority of the legal basis for paying off debts -- unless otherwise specified -- is that they should be payable to the creditor without charge; he is entitled normally to get paid without charge, isn't he?

MR. LORENZO HEBERT: Well, I suppose that is a matter of civil law, on which I am no authority, of course, but presumably if it has been specified in a contract that something must be paid to me at my place of business, well, I am entitled to receive payment there, naturally. If

it hasn't been specified,well, that is another matter.

COMMISSIONER LEMAN: Well, this is another thing that they solve in the United States, isn't it? The creditors do not get charged in the United States, do they?

MR. LORENZO HEBERT: That is the fact in some cases, but in most cases and, as a matter of fact, I think that 90 per cent of the banks are on what they call a par clearing system.

COMMISSIONER LEMAN: What I am groping for is what would be the objections to instituting a system in Canada under which these cheques going through the clearing would all be payable at par?

MR. LORENZO HEBERT: Well, the banks have been considering that, as a matter of fact. Would somebody else like to take that?

MR. PATON: Perhaps one of the different factors in the United States banks which you raise here is that deposits in the United States in many instances do not get validated the day they are made; time is allowed for the clearing of the cheque, so the value given to a particular -- I am not too familiar with the time involved, but there is a system whereby there is some time involved in the validating with regard to the deposit, and in Canadian banks immediate credit is given on deposits made.

DR. McLEOD: May I give an example? When I was a graduate student in Cambridge University, if I got a cheque from Canada payable on a bank in

Boston, I could take it to my bank and deposit it there and get credit within the next day or two days. If I wanted immediate credit -- which I am afraid students usually do -- I had to pay an additional fee. However, I forget what they called it, but I think it was an equivalent interest fee or a minimum fee to get immediate credit.

MR. BOYLES: May I speak to this point? First of all, I think we should recognize that this practice of issuing a cheque to the payee is archaic. Using the same word twice this week, I will probably be reported on again !

COMMISSIONER LEMAN: It is a good word.

MR. BOYLES: Let us admit it, it is archaic. In other words, I agree with the thoughts you had, that the payer of the funds should pay the charges for the transmission of funds.

Now, this involves a lot of other practices which are worthy of consideration and, indeed, are under consideration. As you know, under this rather peculiar system it is very difficult for the paying bank to have access, let us say, to the drawer of the cheque. The Royal Bank in Vancouver might be negotiating a cheque on the Bank of Nova Scotia in Halifax, and this is one of the problems because you don't have an opportunity to procure that charge to which the bank is entitled from the drawer of the cheque in every case and then, of course, there is this unrecovered cost in the event

that some fee is not imposed. There is the clearing cost and the handling cost and, of course, the debit float factor, which is very important. As I say, we have this matter under consideration. It is being developed steadily, and I hope quickly, with a view to seeing what we can do to meet this condition to which you referred.

It is recognized that the present system is not all it might be and it is recognized, too, that in the event that the payee of these cheques is relieved of that charge, that charge must be passed on in some other direction, namely, the drawer, and this is the system that has to be developed.

COMMISSIONER LEMAN: And that is under constant study?

MR. BOYLES: It is under very active study at the present time and has been for some time.

COMMISSIONER LEMAN: The Giro system, has it practically eliminated cases of N.S.F. orders or cheques in Europe?

MR. BOYLES: Well, the creditor system, of course, is most desirable because cover is provided at the time that the request for the remittance is made.

COMMISSIONER LEMAN: Is the handling of N.S.F. cheques in our system quite a costly affair?

MR. BOYLES: It is a very costly affair, because here again you are involved in a colossal debit float while awaiting clearance from

the drawer and, as a matter of fact, there is notice involved, and so on and so on. There is a lot of cost attached to it, and also as we said when we were talking about overdrafts, this is another form of it and you get all these other complications and inconveniences and expense.

COMMISSIONER LEMAN: I certainly visualize that an N.S.F. cheque is a rather messy instrument and that it is costly. Is the volume significant?

MR. BOYLES: The volume is -- if I may use the word -- colossal.

COMMISSIONER LEMAN: Therefore that is an argument for the banks studying the matter and seeing whether any alterations to the system could be ---

MR. BOYLES: And also it is another reason for the elimination of overdrafts. In other words, if you eliminated overdrafts it could gradually correct the practice of people issuing cheques for which there are no funds.

COMMISSIONER LEMAN: You mean that a lot of drawers of N.S.F. cheques are just people who take for granted that the bank will honour them and they will make arrangements later?

MR. BOYLES: Right.

THE CHAIRMAN: I thought that was an alternative!

COMMISSIONER BROWN: Could I ask a question on this? Where is the debit float factor in a certified cheque between the two different systems?

MR. BOYLES: In the case of a certified cheque, Mr. Brown, it is tantamount, you might say, to this European system. In other words, the cover is provided or arrangements are made for the certification of cheques. In other words, a cheque which is certified means that the amount has actually been charged to the customer.

COMMISSIONER BROWN: Why should you charge on certified cheques as on ordinary cheques?

MR. BOYLES: Because you still have got the handling costs, the clearing-house cost, and so on.

COMMISSIONER BROWN: Is there much clearing-house cost between a certified cheque in Vancouver and Montreal and another certified cheque?

MR. BOYLES: No.

COMMISSIONER BROWN: Then why should there be a charge?

THE CHAIRMAN: Why should there be the same charge?

MR. BOYLES: Well, as I said a little earlier, we admit that the system is archaic and is under study. It is one of the factors that is being considered.

MR. LORENZO HEBERT: It is not a case that there will not be any charge to the customers on cheques of over $50,000. The arrangement that the banks have made on a reciprocity basis is that

when these cheques go from one to another there will not be any charge between the two banks, so it is what we pay to another bank today and what they would pay us tomorrow on these cheques, so it reduces the work and the complication, and it makes for very prompt handling of these cheques, and that is the only reason why this system was adopted in 1960.

COMMISSIONER BROWN: Why do you charge the same on certified cheques?

MR. NEAPOLE: The float factor does exist with the certified cheque in the hands of the person who pays it, the bank who pays it to the payee. It exists as a float until it is cleared and settlement is made by the drawee.

MR. LORENZO HEBERT: In other words, if the bank in Vancouver cashes a cheque which has been certified in Halifax, the bank in Vancouver will not get the funds until it is actually paid in clearing house funds in Halifax.

COMMISSIONER BROWN: It can't clear with the corresponding bank in Vancouver?

MR. BOYLES: It could, but there could be a one day delay.

COMMISSIONER BROWN: Say that it was a Bank of Montreal cheque in Halifax cleared by the Royal Bank in Vancouver, don't they get the funds in the Bank of Montreal in Vancouver the same day?

MR. LORENZO HEBERT: The following day.

COMMISSIONER BROWN: That is the same as a Montreal cheque on the Royal Bank in Vancouver?

MR. NEAPOLE: Merely certifying it does change the float factor in that cheque, whatever it may be.

COMMISSIONER BROWN: Could I clarify this point. I understood the float factor -- perhaps I am confused on this -- I understood that the float factor arose from the fact that if you wrote a cheque in Vancouver and somebody clears it in Ottawa, that the bank has to give credit to the somebody in Ottawa before my account is debited in Vancouver, and therefore the float exists. As soon as I certify a cheque in Vancouver my account is debited in Vancouver right then, so in fact there is a float in favour of the banking system?

MR. LORENZO HEBERT: There are always the handling charges.

COMMISSIONER BROWN: We are talking about the float at the moment. People were saying that there is no difference in the float system of chequing and in certified cheques; am I confused on what a float is?

MR. BOYLES: The difference is that you are quite right if the negotiating bank is the same as that on which the cheque is drawn, there will be no debit float in respect of a certified cheque, but if the cheque is drawn on another bank, then there is a delay pending settlement; there is a debit float factor there.

COMMISSIONER BROWN: All right, but is that debit float factor there any more than the

debit-float factor between the same two banks if the cheques were cleared in the same city?

MR. BOYLES: Yes. If I have your questinn properly, I would like to go back to the point I made that if a cheque is negotiated by a bank other than that on which it is drawn -- for instance, let us say that the Royal Bank in Vancouver negotiates a cheque on the Bank of Nova Scotia in Ottawa, the Royal Bank clears that cheque to the Vancouver branch of the Bank of Nova Scotia, but it does not get settlement for that cheque until the following day.

COMMISSIONER BROWN: All right, but if the Royal Bank in Vancouver was clearing the cheque on the Bank of Nova Scotia in Vancouver, when would it get the clearing?

MR. BOYLES: The next day.

COMMISSIONER BROWN: Then there is no difference whether it is a Vancouver Nova Scotia cheque or Ottawa Nova Scotia cheque?

MR. BOYLES: That is quite right.

COMMISSIONER BROWN: That was my point.

MR. BOYLES: There is always a float in respect of all items whether local or out-of-town.

MR. LORENZO HEBERT: The number of these certified cheques, of course, is very small, naturally.

COMMISSIONER LEMAN: One more point, which involves the non-par clearing institutions; can a near-bank offer to its customers -- some of the

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chartered banks do offer par clearing throughout Canada to some of their customers. Can the near-banks do the same thing?

MR. LORENZO HEBERT: We have a branch in Montreal and we see the cheques drawn by customer so and so, we authorize our branch at such a place -- or all branches -- to take that cheque at par; this is our own branches or our own branch.

COMMISSIONER LEMAN: My question was can a near-bank, let us say, situated in the province of Quebec, that wants to offer par clearing for cheques drawn by one of its customers, par clearing throughout Canada, can it do so?

MR. LORENZO HEBERT: Well no, because for that very reason, they only have one office so they can't authorize any branches of the credit union to pay that cheque at par because they have no branches.

COMMISSIONER MACKINTOSH: Couldn't you make an arrangement with the bank that a customer can arrange to have his cheques cashed at par -- I presume for some consideration of some sort -- couldn't the near-bank's customer make the same arrangement?

MR. LORENZO HEBERT: They could make an arrangement with anybody they want to, of course, I suppose.

COMMISSIONER MACKINTOSH: With a chartered bank, I mean?

MR. WADSWORTH: For a fee, or whatever

the case may be, the same as any other commercial customer.

MR. PATON: Your question, I think, was not the Quebec institutions when you speak of the province of Quebec; I think you are thinking of the Caisse, that their cheques would be negotiable at par, and I think your question was could they allot that privilege to their customers.

The justification in obtaining par privileges in chartered banks depends on the creditworthiness of the customer. If the Caisse or any other institution were to endeavour to arrange par privileges for the benefit of their own customers, they would have to examine this very carefully to make sure their cheques would warrant this privilege of par inducement.

COMMISSIONER LEMAN: Well, the Caisse would be responsible.

MR. PATON: But the customer would have this imprinted on the cheque. That is what you envisage, is it not? The Caisse or any other institution would not automatically be willing to guarantee every cheque issued by every one of its customers.

COMMISSIONER LEMAN: No, but do the banks guarantee each other for the creditworthiness of the customers to whom they grant this privilege?

MR. PATON: Not specifically, no. It is not a privilege that is handed out easily. That is the point I wish to make.

COMMISSIONER LEMAN: I do not feel it would be too useful to discuss in detail all the difficulties, the mechanical difficulties, of the ideal clearing system. You have already explained that this is always under study, that there are lots of ramifications to consider. Could we get some principles down on the record as a system under which any institution needing clearing facilities could have access to a clearing system, provided it was willing and able to observe all the reasonable rules that are required in order to

efficiently make a clearing system function and pay its fair share of the costs. These are reasonable principles.

MR. HARRIS: That is a very fair statement. The mere fact that the near-banks issue these cheques and issue orders, I think, is proof that they have access to the clearing system of the banks.

COMMISSIONER LEMAN: They do, but under special terms and conditions.

MR. HARRIS: Yes. But the terms and conditions are laid down, and to my knowledge these privileges have never been denied to anyone who has asked for them and who has agreed to the terms and conditions, which incidentally we consider to be quite reasonable.

COMMISSIONER LEMAN: You have already told us that the clearing service you give these other institutions in exchange for a charge is done at a loss to you. If we say "access to a clearing system on equal terms and conditions," they would presumably pay a little more for the service, if you are making a loss on it now.

MR. HARRIS: Well, sir, there are a good many of the services that the chartered banks perform, I think it is agreed, that on a cost basis are carried out at a loss. I think it is also true to say that these are constantly under review. As to the question of exchange charges, referred to by Mr. Boyles, that is something which is very much under active consideration at the present time.

COMMISSIONER LEMAN: Because, as Mr. Hebert

pointed out to us, the volume of orders handled through the non-banking system is quite small in relation to the volume of such orders handled through the banking system, but there is no telling where that will be some years hence. The relationship could change. I have nothing more on this point, Mr. Chairman.

THE CHAIRMAN: We shall adjourn for ten minutes.

--- Short recess.

THE CHAIRMAN: We shall now resume.

COMMISSIONER MACKINTOSH: I should like to ask some questions in a field on which I have quite inadequate knowledge. I refer to the foreign currency business of the banks. It is quite clear from your brief, of course, and general knowledge, that certain customers of the banks wish to keep foreign currency accounts for the purpose of receiving funds and making payments without going through the exchange market each time.

There are other foreign currency accounts which, I presume, are attached to the banks' subsidiaries or agencies located in foreign countries. What type of regulation are these banks or agencies subjected to in the foreign countries? I take it they are free of Canadian regulations. What is substituted for the Canadian regulations in these countries?

MR. NEAPOLE: May I suggest that Mr. Shannon and Mr. Griffiths answer these questions for you.

MR. SHANNON: Dr. Mackintosh, in each foreign country where we operate we are subject to the banking laws of that particular country. Quite a variety of cash reserves are required. I have a list of them all here if you wish it for the record. This list is long and varied, but in the broad picture we operate under the banking law of the particular country in which we are located.

COMMISSIONER MACKINTOSH: What does that involve, briefly, say, in the United States?

MR. SHANNON: I will break it down by states. In New York state we may operate as an agency or, through a change in the law a few years ago, as a branch. No Canadian bank has elected to operate as a branch. We all operate as agencies, which means that we are restricted in our operations to the extent that we cannot take deposits from residents of the United States. This is laid down. We may maintain, for the account of others, credit balances incidental or arising out of the exercise of our lawful powers, which are described as buying, selling, paying or collecting bills of exchange, and so on. But we are not allowed to take deposits as such from residents of the United States.

We all have Canadian customers with accounts in New York, and those banks with branches in the West Indies and South America have a great deal of business from those countries as well.

COMMISSIONER MACKINTOSH: Does that differ greatly in the United Kingdom?

MR. SHANNON: In the United Kingdom we can

do general banking business. We can do anything the United Kingdom banks can do. In most cases we can do what the local banks do.

COMMISSIONER MACKINTOSH: Do you,in fact,in the United Kingdom have much in the way of deposits by United Kingdom residents?

MR. SHANNON: Yes, I believe we do. I speak for our own bank. We have a good deal of business from United Kingdom residents. Perh s it is slanted towards customers who have dealings in international trade, in Canadian business in Latin America and the West Indies, letters of credit business, and that sort of thing, but we are not restricted to that and we do have some strict U.K. business.

COMMISSIONER MACKINTOSH: I take it that,as an agency in New York,you are not subject to any reserve requirements?

MR. SHANNON: No, we are not but we make a statement each week to the Superintendent of Banks in New York city, showing our liquid position. We are quite satisfied that if he were not completely happy with that situation we would hear about it.

COMMISSIONER LEMAN: Dr. Mackintosh, may I interject something here?

COMMISSIONER MACKINTOSH: Certainly.

COMMISSIONER LEMAN: Mr. Shannon, you said that you had a long list to read of the reserve requirements on branches in foreign countries. Could you file that with the Commission later?

MR. SHANNON: Yes, I would be very pleased to.

We are also subject to inspection in each of these countries by the local bank inspectors. In New York city we are inspected just as the New York banks are.

COMMISSIONER MACKINTOSH: In respect of your foreign currency loans, aside from call loans, do the sizes of these loans differ markedly from the average or representative size of Canadian loans?

MR. SHANNON: Are you speaking of New York, sir?

COMMISSIONER MACKINTOSH: Well, yes.

MR. SHANNON: In New York, I would say no, that there would be very little difference in size. We would not have the small personal loans that we have in our branches in Canada. The loans would be on a larger scale, but as far as the top limit goes there would be very little difference. In some countries we are restricted as to the amount of loan to a certain percentage of our capital, and that sort of thing.

COMMISSIONER MACKINTOSH: Does most of this loan business in foreign countries arise out of Canadian trade and business?

MR. SHANNON: Oh, not at all. I suppose it is safe to say that in New York perhaps 70 per cent of our loan business there has some connection either with Canadian or foreign countries where we have branches. In the West Indies the Canadian banks, along with Barclay's and BOLAM, are the banking system. So we are doing the general banking of the country. In the countries of Latin America we are part of the banking system, doing the general banking business.

COMMISSIONER MACKINTOSH: What has been the role of the Canadian banks in the New York money market?

MR. SHANNON: We handle a good portion of the call loans in New York. Is that what you are referring to particularly?

COMMISSIONER MACKINTOSH: Yes.

MR. SHANNON: We have over the years built up quite a large call loan business there. We do this business at a slightly lower rate than the larger New York banks because we are not in the position to offer the reciprocal benefits to the brokers and investment dealers that the New York banks can. Therefore, we take it on at a little lower rate. That is our principal role in the New York money market itself.

COMMISSIONER MACKINTOSH: How closely is that business controlled by the head office? I do not mean the New York money market business but --

MR. SHANNON: The foreign business?

COMMISSIONER MACKINTOSH: Yes.

MR. SHANNON: Oh, very closely. We have local supervision in many areas. We would have a supervisor in, say, Jamaica, and we would have a supervisor in Brazil. It operates much like the Canadian system where the district head has authority up to a certain amount and he carries on the every-day administration of his district, with the head office giving the same supervision as we would to a Canadian district.

COMMISSIONER MACKINTOSH: I noticed in your statement that the banks have considerable foreign

currency deposits or balances with other banks. Would you care to say something about this? What is the extent of these interest-bearing or non-interest-bearing deposits? What is their function?

MR. SHANNON: Well, we have a long list of all correspondents the world over which Canadian banks have. In certain cases we carry balances with these correspondents to take care of the ordinary exchange of business, clearing of mail transfers, letter of credit drawings, and so on. These are on an interest-free basis. These are our working balances with other banks.

In each Latin American country in which we operate we have to carry cash reserves with the central bank. That is all included in these totals with other banks. Over and above that we have deposits with them on interest-bearing business, and a large part of these free balances are also compensating balances where the foreign bank may send us a lot of credit business and collection business which, because of trade conditions, we may not be in a position to reciprocate. We may do it by carrying a free balance with them. This is compensating.

As far as interest-bearing balances go, we invest certain funds with other banks on an interest-bearing basis.

COMMISSIONER MACKINTOSH: These have increased fairly rapidly, have they not, in the last while?

MR. SHANNON: You are referring particularly to the so-called Euro-dollars?

COMMISSIONER MACKINTOSH: Yes. I would be glad if you would elucidate that mysterious term.

MR. SHANNON: That is a misnomer. It should be "international dollars".

COMMISSIONER MACKINTOSH: I find that applies to many terms bankers use.

MR. SHANNON: It started in Europe and was given the name Euro. It really means U.S. dollar deposits in banks outside United States. That is as good a terminology as you can give it. This has grown up particularly in the last few years and it has come to be as close to an international currency as you could get for trading purposes. To be useful,this currency must be useable. It must be free of restrictions and it must be readily available. Until the last five or six years United States dollars were not readily available in the foreign lands.

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With the U.S. deficit on balance of payments, U.S. aid programs, military forces abroad, and so on, within the past five or six years foreign holders have built up balances in U.S. dollars, so the U.S. dollar has been readily available abroad. It has always been useable, and it is cheaper. That is, interest rates being cheaper in the United States, it is cheaper to finance that way in international trade than sterling, in which most of this trade was carried on before. There were certain restrictions on sterling that did not make it a desirable currency to use in international trade. With all these conditions this Euro-dollar market has been built up. It was developed by the London money market principally, who had the know-how for handling these transactions, and with the availability they developed this Euro-dollar market in London, and it got the term "Euro-dollars." There are others -- Euro-Canadian, Euro-Sterling, Euro-Swiss, which are just as well known as Euro-dollars.

COMMISSIONER MACKINTOSH: And these are assets in insitutions outside the United States?

MR. SHANNON: Right.

COMMISSIONER MACKINTOSH: There is one point not quite clear to me. I may have created the confusion myself. How does this relate to the deposits with other banks?

MR. SHANNON: We take Euro-dollar deposits first. Let me first say where we get them from. We get them from many sources: from Canadian residents who have U.S. dollars and do not need to use them immediately,

and put them on deposit with us for a short-term; we have them from American corporations and foreign banks. This is all on a short-term basis. This money is very moveable and very sensitive to rates and can be moved across international boundaries. Very little is over 180 days, and we have it from all these sources and we must employ it, if we can, profitably, and we do not take it on, naturally, unless we can. We have very conservative liquidity formulae, and each bank has its own because these funds are short-term and volatile and we must keep them very liquid. We have treasury bills in New York and short-term government loans, and so on. We put them out on short-term -- thirty, sixty, ninety days -- with other banks. These banks are principally in London. Most of the Canadian banks have limits as to the amount they will place with any particular bank. It is a very select list of banks, and the overall amount, how much they will put out in this market, may vary according to the season of the year, because these funds are more sensitive to seasonal fluctuations. They are principally in London, some are in Germany, some in France and some in Italy. I do not know if any of the Canadian banks have gone into Japan. The Japanese are active seekers for these deposits and will pay a higher rate. These rates are determined pretty well in the London market. One of the advantages the Canadian banks have in this field is because due to our prestige and location in North America we can obtain funds at slightly less than the market rate in London, so we have this very narrow spread.

It is a volume business done on a small margin, and it is profitable.

COMMISSIONER MACKINTOSH: What ... other advantages than prestige have you in developing this business?

MR. SHANNON: This has developed gradually. One of the advantages is undoubtedly the so-called Regulation Q in the United States, by which the Federal Reserve Board suggests maximum amounts the United States bank can pay in one kind of money. Up to a year ago they were of this order: 3 per cent on savings; up to 90 days, 1 per cent; 90 days to six months, 2½ per cent; 6 months to 1 year, 3 per cent; and 1 year more 3%. There was some relaxation on that a year ago, and the American banks, on long-term, could go up to 4 per cent; but they have not. So that this makes us feel it has not unduly restricted them, and if they did want to go higher they could do so. In their London office the U.S. banks use the Euro-currency and do not become involved in Regulation Q.

COMMISSIONER MACKINTOSH: So vis-a-vis Regulation Q you get a somewhat similar advantage to that of the trust companies vis-a-vis the ceiling on interest rates?

MR. SHANNON: You might say so, except that the American banks have not come up to the maximum on the longer term that they could have. If money was tight in the United States and they needed additional funds they could come up to that maximum.

COMMISSIONER LEMAN: Dr. Mackintosh, may I

interject a question here to Mr. Shannon? Did I understand your explanation correctly? Is it true to say that the Canadian banks hold liquid reserves against U.S. dollar deposits from Canadian residents, but no true cash reserve against those?

MR. SHANNON: These are U.S. dollar deposits, Mr. Leman. Do you mean U.S. dollar deposits for Canadian residents which we reserve against those per se?

COMMISSIONER LEMAN: There is no cash reserve against that, is there?

MR. SHANNON: No more than there is on our ~~U.S.~~ dollar deposits in New York. If they were deposited with our New York agency in New York there would be no cash reserve there either. These funds can only be used in the New York market. The transfers all take place in the New York market, and you cannot utilize them anywhere else.

COMMISSIONER LEMAN: This puzzles me, in the light of section 71(4) of the Bank Act.

MR. SHANNON: We do maintain adequate reserves. They are not official reserves in the sense we have a formula. But we do feel they are adequate cash reserves. I venture to say that each bank's liquid position is far greater in this business than it is in the Canadian business or most of our other foreign business in countries where we are subject to higher cash reserves than in Canada.

COMMISSIONER LEMAN: What you keep there is adequate liquid reserves?

MR. SHANNNON: Yes, exactly.

COMMISSIONER MACKINTOSH: Following on that point, Mr. Shannon, is not there a certain transfer of Canadian deposits into foreign currency with a swap arrangement which guarantees them, which relieves you of a required cash reserve which would have applied had they remained Canadian deposits?

MR. SHANNON: That is a lending of funds for an exchange of Canadian funds. Mr. Griffiths is an expert on swaps, and I think I will let him take over on the actual mechanics of the swap field.

MR. GRIFFITHS: The fact these monies are swapped into United States money is not a means of avoiding any reserve regulations in Canada. It is purely an interest factor. We are subject in Canada to competition for these deposits in Canadian dollars. Corporate treasurers have been educated and they now have very sharp pencils and are looking for a higher interest yield. They know of this mechanism whereby they can buy U.S. dollars on a swap basis and put them on deposit, and with the spread on the swap plus the interest yield on the U.S. dollar deposit they are then able to obtain a higher net return on their money than they could do by placing them on deposit in Canada.

COMMISSIONER MACKINTOSH: Who do they derive the higher yield from?

MR. GRIFFITHS: From the Canadian banks.

COMMISSIONER MACKINTOSH: Why can the Canadian banks pay a higher yield than they could on Canadian funds?

MR. GRIFFITHS: Perhaps I had better go into the mechanics a little. A customer comes to you and says, "I want to do a swap." In fact, what you do is you take his Canadian dollars and you sell him U.S. dollars spot. You place those dollars on deposit for him at a given rate, the ruling rate that you would pay on any U.S. dollar deposit fixed for a term of 30 days, 60 days -- whatever it might be.

COMMISSIONER MACKINTOSH: I understand this is a highly competitive field, is that right?

MR. GRIFFITHS: Yes. There is a profit on the swap transaction by selling the spot and buying back the forward. In other words, the banks go into the market on the reverse market. Forward dollars are at a premium. So we go into the market and buy spot dollars simultaneously selling the forward, and there is a premium on that which accrues to the bank. So the combination is, what you pay on the U.S. dollar deposit plus the forward premium and that, as I said, is higher than the yield which a customer could get on placing the deposit in Canada.

COMMISSIONER LEMAN: But why?

MR. GRIFFITHS: Because of the fact there is the premium on the forward dollar. There is a spread between spot and forward.

COMMISSIONER LEMAN: The Canadian who does the deal with the bank, he started with Canadian funds?

MR. GRIFFITHS: Yes.

COMMISSIONER LEMAN: And he is going to end up with Canadian funds sometime later? Is it that

through the period in question the yields are higher in the U.S. than they are in Canada?

MR. GRIFFITHS: The combination yield of the interest rate and the swap is higher than the current rate in Canada. The reverse might easily apply and has, indeed, during recent years, whereby it was more profitable for a U.S. corporation to bring the money up into Canada on a swap basis. In fact, this is done through the exchange market in London at all times in various currencies.

MR. SHANNON: Money moves around from one currency to another, wherever it can get the best rate.

COMMISSIONER LEMAN: Is it possible that an American could be buying this in Canada while an American is buying it in New York?

MR. SHANNON: No.

MR. GRIFFITHS: The movement is from one currency into another, up to the time it is still profitable. When the interest rates in one country become higher the money moves back.

COMMISSIONER MACKINTOSH: And the assets represent this deposit, or are the contra for the deposit. Is that in Canada?

MR. GRIFFITHS: No.

COMMISSIONER MACKINTOSH: It is in the United States?

MR. GRIFFITHS: Yes, in the United States.

COMMISSIONER MACKINTOSH: That is, you use the, as it were, deposit in the United States currency to invest in the United States, and it may be in the

money market or securities or a deposit with an American bank, or whatever you think is the appropriate one.

MR. SHANNON: Once the swap is done that is another U.S. dollar deposit, the same as if we received it from a foreign bank for an American corporation, and it is invested in the same way as our other funds outside Canada. But if it goes into deposit it might be loaned in Canada to an American corporation, but it can only be utilized in the Canadian market.

COMMISSIONER MACKINTOSH: The profit possibilities consist of the premium on the higher dollars plus the higher rate of exchange?

MR. SHANNON: The higher rate of interest.

MR. GRIFFITHS: You might have a lower rate of interest in the United States than in Canada. But the forward premium makes it more profitable to make the switch into U.S., the interest rate combined with the forward premium amounting to more than the interest rate in Canada. That is the object of the transaction.

COMMISSIONER MACKINTOSH: You say that this is always at the initiative of the customer, and it is not a way of at any time transferring deposits from the required cash ratio category to a non-cash ratio category?

MR. SHANNON: When we do the swap and the Canadians get title to a U.S. deposit someone in Canada gets the title to his Canadian funds, so they are in the Canadian banking system some place and are reserved for whatever course of events. It is an exchange

of currencies for a said period so there is no change in the money supply in Canada, and there is no change in the amount of Canadian dollars on deposit.

COMMISSIONER MACKINTOSH: Does it follow from that that you would think the Canadian cash reserve requirements were properly restricted to Canadian dollar deposits?

MR. SHANNON: Very much so.

COMMISSIONER MACKINTOSH: My recollection is hazy, but was there not an earlier situation where this was not true?

MR. SHANNON: I am not aware of it, sir.

COMMISSIONER MACKINTOSH: I may be quite wrong. I think that is all I have, Mr. Chairman.

COMMISSIONER LEMAN: I have one more question on this. Is nothing changed? You explained to us, because of the swap transaction the Canadian total deposits in the banking system are not changed. But have we not ended up there with the same total of Canadian deposits in the Canadian banking system, plus something outside the country we did not have before?

MR. SHANNON: The persons who did the other side of the swap and took the Canadian and gave up United States dollars, they might have been in New York, or a Canadian bank, or anywhere. They might have been in the name of a Canadian bank, but not in Canada.

COMMISSIONER LEMAN: What has been added in Canada has been offset by what is lost in the States?

MR. SHANNON: Not necessarily. Someone had a Canadian dollar deposit, and one person had a

Canadian deposit and someone else got it in Canada. That second person had U.S. dollars and gave up the title to those, wherever they were situated, to the Canadian.

COMMISSIONER LEMAN: I am not sure I understand it yet. You told us this does not change the total of Canadian dollar deposits, but a Canadian now has something in New York on top of it.

MR. GRIFFITHS: Perhaps I could clarify that a little, Mr. Leman. When a Canadian bank facilitates a customer this way, we go into the market to buy the spot U.S. dollars. That means that we acquire spot dollars from, say, a Canadian bank. They have the dollars in New York.

So, they give up the dollars in New York, we transfer the equivalent in Canadian dollars to them in Canada, and nothing is changed in Canada and nothing is changed in the United States. We have the Canadian claim against the U.S. dollars and the Canadian situation has not altered.

If we do this transaction with an American bank we can acquire the U.S. dollars from an American bank. We give up to them Canadian dollars; those Canadian dollars we pay to another Canadian bank for their claim. So an American bank has acquired a claim against Canadian dollars; a Canadian bank has acquired a claim against U.S. dollars.

COMMISSIONER LEMAN: Because a forward exchange transaction has entered into this picture, there is a liability that has been created to return the Canadian dollars?

MR. GRIFFITHS: That is inherent in the forward contract. Then you do your swap.

COMMISSIONER LEMAN: Is it not true that as a result of this transaction the total Canadian dollar deposits have not changed in the banking system, and on top of that a Canadian has an asset in New York which he did not previously have?

MR. SHANNON: But we don't know who had the asset in New York before; it might have been a Canadian.

COMMISSIONER MACKINTOSH: May I interject?

Would this be correct, that the possibility of U.S. deposit being added to an unchanged Canadian deposit, as Mr. Leman suggests, depends on what the balance of the transaction is. If the total of these operations, plus all other operations, amount to an import of capital, then you have the basis for an increase in the total assets of the Canadian banking system? Does that just confuse the matter?

MR. SHANNON: It is not an import of capital, because the funds remain in New York. We have title to a deposit of U.S. dollars, which can only be in New York. Suppose the Bank of Canada were in the swap market and swaps were done with the Bank of Canada, and suppose they did not sell treasury bills to do the swap, then there would be an increase of money supply in Canada. This would only be so if the Bank of Canada was in the market to do a swap and it was there with full knowledge and desire. If the Bank sold treasury bills to do the swap, there would be no change in the money supply, but if they did it without selling some asset, it would change the money supply, but it would only be when they wanted to change it.

COMMISSIONER LEMAN: Are you changing the money supply in a restricted sense from which it is used? Could we say that there was a change in the total of money supply, plus near money supply?

MR. SHANNON: I wouldn't even go that far. It is just a change of ownership of a deposit for a certain time. That is a swap that comes to you -

a swap of one currency for another for a certain period of time.

COMMISSIONER BROWN: If you are dealing with a customer who wants these American dollars and you carry out the swap within your own bank, could you not sell the American dollars to the customer and wipe out a Canadian deposit?

MR. SHANNON: We can't wipe out a Canadian deposit. We have title to his Canadian dollars.

COMMISSIONER BROWN: You, in fact, on your books wipe out his Canadian dollars just as if you sold him some securities from your investment account.

MR. SHANNON: Yes.

COMMISSIONER BROWN: That is, if you sell him the American dollars?

MR. SHANNON: That is a straight exchange transaction, a sale of U.S. dollars.

COMMISSIONER BROWN: And you are carrying on a swap within your own system. You undertake to re-deliver the American dollars in ninety days. Have you not reduced the total deposit in Canada?

MR. GRIFFITHS: If you do it on your books, Mr. Brown, without doing it in the market that is what is known as a "phoney swap".

COMMISSIONER BROWN: Is a phoney swap technically possible?

MR. GRIFFITHS: It certainly is possible.

COMMISSIONER BROWN: There can be a

transaction if one wants to do it on this basis which would reduce the deposits in Canada, thereby reducing your reserve in Canada?

MR. SHANNON: You would possibly take the Canadian deposit and tell the customer that there was going to be a swap and go through a contract with him, and then merely designate that on the books. In that event the bank would be evading the reserve requirement.

COMMISSIONER BROWN: And it calls on you for a higher interest rate?

MR. GRIFFITHS: Yes. This was discussed with the Governor of the Bank of Canada about ten months ago, when each bank sat around a table and assured the Governor that they would not do this. As I say, this question came up, and we assured the Governor that this does not happen.

COMMISSIONER BROWN: Thank you very much.

MR. GRIFFITHS: Perhaps I might add a point. You suggested that one might do it on his books without going into the market. If the bank's exchange position is such that in the normal course of trading, which is a market operation, your spot position is long and you are short on forward, you do it on the books without going into the market, but that is a market operation. In other words, you would want to do it in the market anyway, and you do it with your customer instead. That of course is not a phoney swap.

COMMISSIONER BROWN: It could be a swap but it is not a phoney swap, one which would reduce your cash requirements with the Bank of Canada?

MR. SHANNON: Yes, until you can adjust your position. Sometimes you cannot adjust your position in the same day.

COMMISSIONER BROWN: That can be done without contravening the wishes of the Governor of the Bank of Canada.

MR. SHANNON: Exactly.

COMMISSIONER HARROLD: I have a question or two on personnel policy. In your section 9 on recruitment and training policy, you mention there the transfer of personnel which is done in banks as a training technique.

Have you increased your specialties department? In other words, have you personnel that is being trained specifically for counselling on lending to certain industries? Is there anything of this nature being developed in the bank now, and if not, would it be a good thing if it were?

MR. NEAPOLE: I should say that there has been quite a bit of training in the agricultural field through attendance at various lectures and courses which have been given by the Ontario Agricultural College. We have a man who is described as our agricultural representative, and we do train people for that purpose. I think it is also safe to say that in Alberta some of our men have had training in the oil field.

COMMISSIONER HARROLD: Does the policy of transferring interfere with the specialty function of the department?

MR. NEAPOLE: We do our best to see that it does not interfere.

COMMISSIONER HARROLD: Turning for a moment to the question of directors, it has been suggested to us that one of the chief reasons for appointment to the Board of Directors is because of the fact that a person may be in a company which is a large borrower from the particular bank, and such a person is selected as a director of the bank. Have you any estimate of the authorization in any particular bank for the appointment of directors who are interested in certain businesses which are borrowers of the bank?

MR. WADSWORTH: In that connection, Mr. Harrold, full information is placed before the Minister of Finance every month.

COMMISSIONER HARROLD: So, figures are available.

MR. WADSWORTH: And there are also the safeguards in the Bank Act, as to the consideration of credit by the Board, and no director may be present when his own credit is being considered.

COMMISSIONER HARROLD: The techniques described in the act are followed?

MR. WADSWORTH: Yes, they are very definitely spelled out as requirements.

COMMISSIONER HARROLD: Similarly, are

there other persons selected for membership on the Board of Directors who might be said to represent the depositors?

MR. WADSWORTH: I would hope that all directors would do so.

COMMISSIONER HARROLD: I suppose this would also mean that the general public would be represented, that all directors would represent the general public.

I refer next to your paragraphs 170 to 175. In paragraph 172 you say:

> "In spite of repeated requests compensation has not been put on a properly designed basis and it is now considered very inadequate in relation to the sharp rise that has taken place in the volume of government business."

Have you any estimate of the costs involved and the size of adjustment you would like to see in individual banks in this business?

MR. BOYLES: Mr. Harrold, from time to time the government of Canada's business, as handled by the banks, is reviewed in its entirety, and costs studies that have been made as a result show that it is costing us something in excess of $7 million.

COMMISSIONER HARROLD: Is that the total?

MR. BOYLES: Yes, that is in the aggregate.

COMMISSIONER HARROLD: You mention a section of the act under which the government gets this service.

MR. BOYLES: Yes, it is section 93 (1) of the Bank Act, which prevents the bank from charging on cheques or other instruments issued by or payable to the government.

COMMISSIONER HARROLD: You have not had much results from your discussions with governments in getting this adjustment made as far as your costs are concerned?

MR. BOYLES: No, not up to this point; although, it is only fair to say that discussions are continuing.

COMMISSIONER MACKINTOSH: Is the figure of $7 million net of the advantage of the government deposits?

MR. BOYLES: Yes. Allowance is made for the deposits.

COMMISSIONER HARROLD: In connection with the inspection system, do you see any virtue in the idea of a larger system which would take in not only the banks but possibly other institutions?

MR. BOND: Mr. Harrold, there does not seem to be any particular advantage in having a board of people to carry out the inspection. The banks have found over the years that the office of the Inspector General has worked extremely well and, incidentally, it is very economical. As far as the banks are concerned, it is very satisfactory and

we do not wish to see it changed.

COMMISSIONER HARROLD: Those are all the questions I have, Mr. Chairman.

COMMISSIONER BROWN: I should like to ask a question about the directors, and perhaps the question may be regarded as backwards. I should like to get some comment on the propriety of senior officers of banks acting on boards of directors of customer companies.

MR. MULHOLLAND: Mr. Brown, I think that each bank would have a very definite policy in that regard. Therefore, I cannot speak for the Association. Other general managers may wish to speak for their own institutions.

If I may speak for my own bank, we have a definite policy in this respect. In so far as it relates to management that has a responsibility for the day-to-day conduct of banking affairs of its customers, there could arise at times a conflict of interest which can be avoided by following the policy of not allowing management to go on boards of companies.

COMMISSIONER BROWN: There seems to be a unanimity of dead silence.

MR. PATON: I think that is an example of the politeness of bankers -- we are waiting for the other to take the initiative.

On behalf of our bank I would say that it is a matter of judgment. Within reason, we do not see the danger that has perhaps been indicated.

We have a policy which allows officers of our bank to serve as directors of companies whose business we are entrusted with. To date there has been no indication of any conflict of interest. We would certainly make sure that such situation did not arise, and if it did proper steps would be taken to correct it.

COMMISSIONER BROWN: Other customers have not complained about this policy?

MR. PATON: No, not to our knowledge.

COMMISSIONR BROWN: I believe you were about to say something, Mr. Boyles?

MR. BOYLES: I was going to say something to the order of what Mr. Paton has just said. In our case we endeavour to refrain from having officers join the boards of commercial companies, because naturally we may have several clients who have comparable interests. This does not necessarily hold true to the same extent in the area of financial institutions. I am sure it is pretty well known that there are officers of banks sitting on boards of trust companies, insurance companies and the like.

MR. WADSWORTH: If you wish me to comment on that, Mr. Chairman, we follow a policy fairly similar to that expressed by Mr. Mulholland, that senior operating officers of the bank generally are not permitted to go on boards. There are a few executives at the senior level who are allowed to do so, but if there were any conflict of interest at any time such officer would remove himself from the

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board forthwith. So far that has not occurred.

COMMISSIONER BROWN: Thank you very much.

MR. WADSWORTH: I might also add in that connection that from a practical point of view if officers, even at the relatively senior level on the operating end, were permitted to join boards, such senior officers have other responsibilities that require them to move throughout the country. If the company were a local organization, problems would be created by such movement, and the officer would have to resign from the board.

MR. PATON: I might further comment on our situation similarly with regard to the privilege of joining such a board, which is limited to top executive officers.

MR. NEAPOLE: We don't do it at all in the management area - just vice-presidents and up. I am a director of Roynat Ltd., but that is all.

COMMISSIONER BROWN: In that case you represent the shareholdings of the Royal Bank.

I am reminded that there is a section in the Bank Act which refers to a two-thirds majority of the directors being required when authorization is being given to a loan above a total amount of 5 per cent of the paid-up capital of a bank in the case where a director of the bank is either a director or even a shareholder of the company involved. With the increasing size of banks, is 5 per cent of the

paid-up capital a reasonable figure now?

MR. MULHOLLAND: With the increase in the capital, a reasonably close relationship is probably being maintained.

MR. WADSWORTH: I think also that is taken in conjunction with section 75(3) where any director, regardless of the amount of credit, may not be present at a meeting of the board where credit is being considered and in which he has an interest either directly or through a subsidiary; if you put the two together I think that the present safeguards are quite adequate.

COMMISSIONER BROWN: There are two things that occur to me, and one is whether 5 per cent has become such a high figure that it doesn't become operative very frequently, and the other one, of course, is the thing that with the widespread share ownership of bank directors, it must be difficult to find a situation where you can authorize a loan of this size without having to comply with this section because one of your directors is bound to be a shareholder.

MR. MULHOLLAND: Sometimes the board room is rather empty!

COMMISSIONER BROWN: I am talking about the shareholdings, not interlocking directorships. I am talking about section 75(2)(f), "a member or shareholder". As I say, there are two points involved; whether that clause is operative very frequently, and the other one is whether you couldn't just have that sort of clause, whether a loan exceeds that size or not, without the conditions about a director being a shareholder because, as I say, there must be very few cases where you have a big one like that where you haven't got a director as a shareholder.

MR. BOND: The usual function is to go through

the registers and look for those cases and check that they are reserved.

COMMISSIONER BROWN: I am quite satisfied they are reserved; I am not questioning that in the slightest.

MR. BOYLES: I don't think that the existing provisions of the Act have made for any undue inconvenience.

COMMISSIONER LEMAN: I can't hear you.

MR. BOYLES: I am sorry. I suggest, Mr. Leman, that the existing provisions of the Act have not made for any noticeable inconvenience. Does that answer your question?

COMMISSIONER BROWN: If it does give rise to any noticeable inconvenience, it is a suggestion that this maximum limit is so high now that it is seldom exceeded.

COMMISSIONER MACKINTOSH: There doesn't seem to have been the necessity for considering it very often.

MR. WADSWORTH: You are speaking of the 5 per cent?

COMMISSIONER MACKINTOSH: Yes.

MR. WADSWORTH: And there are cases probably in most banks.

COMMISSIONER BROWN: Apparently there is no opinion, so let us go on to the next point.

COMMISSIONER MACKINTOSH: Is it fair to as. if anybody recalls cases in which this requirement ha denied a loan which would have been accepted if the

two-thirds majority had not been required?

MR. BOYLES: I have seen no such case.

MR. NEAPOLE: Nor I.

MR. PATON: Nor I.

COMMISSIONER MACKINTOSH: I would hope that there were not too many loans that were approved by one majority vote!

COMMISSIONER LEMAN: Mr. Brown, are you going to leave interlocking problems here, because I would like to raise a question?

COMMISSIONER BROWN: I thought that subject was dropped on the floor first thing this morning?

COMMISSIONER LEMAN: I would like to raise an interesting interlocking directorship idea here. What would the banks think of the idea of packing the Bank of Canada Board with senior officers of the chartered banks? This sounded facetious, but I am asking the question seriously and I will reword it. What would be the true objection in having directors and senior officers of chartered banks on the Bank of Canada Board?

MR. MULHOLLAND: Conflict of interest might arise, Mr. Leman, unless, of course, the Bank of Canada adopted a procedure similar to the withdrawl procedure of directors in the chartered banks when matters arise that get into the area of conflict of interest, then the banker or bankers might withdraw during that particular discussion.

COMMISSIONER LEMAN: I was thinking of it in the context of what was discussed earlier to the effect that you felt it was the Bank of Canada that doesn't

need to have too much extra back-up powers, etcetera, without discussing the necessity for having certain connections with the bank, etcetera, and it would suggest that this could be done through meetings with the banks, with a direct contact through having some representative of the banks on the Board of Directors of the Bank of Canada, perhaps to ensure that the discussion would be that much more certain; it was only in that context I was thinking of it.

MR. PATON: If I may come into that; we have been discussing competition this morning, and unless all the banks were represented on a Bank of Canada Board there would be a competitive advantage or disadvantage, depending on whether you were inside or outside.

MR. MULHOLLAND: That would really be packing the Board!

MR. BOYLES: It is also suggested it would be a matter of decency in respect of the oath of secrecy.

COMMISSIONER LEMAN: I think you have answered my question.

MR. NEAPOLE: We have often felt that a working banker wouldn't hurt their Board.

COMMISSIONER LEMAN: Well, I was going to raise a question here, and if Mr. Boyles would allow me to use the word "archaic", I need it for my question.

Can it be considered archaic to continue to force the banks to have necessarily par value stock when ordinary companies don't have to have par value stock?

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MR. HACKETT: In answer to that, Mr. Leman, I don't think it could be considered archaic; I think there is some weight that has to be given to custom and useage in this connection. It is something that the banks naturally will be having under consideration as we approach the revision of the Bank Act. There are a number of technical factors involved but there is also, I think, the question which is perhaps a little mystical as to whether in the view of the public a bank should have a par value, whatever that par value might be. I don't raise this as a sensible consideration, I raise it as a consideration that may be in the public mind.

COMMISSIONER LEMAN: A bit of a mystique?

MR. HACKETT: I think so.

COMMISSIONER LEMAN: But the banks would have no objection to the legislature taking that problem by the hòrn, so to speak?

MR. HACKETT: I think in this area, Mr. Leman, the banks would probably prefer to be perhaps permissive. I can't think of any technical objection.

COMMISSIONER LEMAN: It is permissive now for ordinary companies under letters patent; they can have par value stock or no par value stock.

MR. HACKETT: That was the point I was endeavouring to make. It would broaden the area of action for the banks in this particular area if it were felt desirable,all things taken into consideration.

COMMISSIONER MacKEEN: Is this a hold-over to the days when there was a double liability?

MR. HACKETT: I would answer that precisely that way, sir, when the double liability feature existed par value was necessary.

COMMISSIONER LEMAN: I believe that it was the savings banks who represented to us that the question of the par value of their stock and the requirements of directors' qualifying shares would make things a little difficult at times. Is there a similar problem for the chartered banks?

MR. WADSWORTH: As to directors' shares?

COMMISSIONER LEMAN: Yes.

MR. WADSWORTH: Not that I am aware of.

MR. MULHOLLAND: I think it would be the view of all the banks here that there would be a similar view to that of Mr. Wadsworth.

COMMISSIONER LEMAN: This brings me to another question relative to disclosure requirements; banks are under the private enterprise system, and we have heard quite a lot of representations throughout Canada about the form of reporting to the shareholders, the amount of information that shareholders can derive from annual reports, and I believe yesterday or the day before I asked a question about whether the banks felt that there were adequate disclosure requirements in general for corporations in Canada, and if I remember correctly, Mr. Hackett spoke and said that he thought that you were pretty well endowed with adequate disclosure in general in Canada. Nevertheless, there re areas where people have represented to us tha they not get the tremendous amount of information they would like to have

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from bank reports, especially in the area of the annual result. Would you care to comment on this?

MR. HACKETT: I would think that the position as to the balance sheet, profits, and taxation is in that sense comparable with the annual report technique and in addition, of course, I should add that for the banks as a whole a very detailed report is available to the public to the medium of what we call schedule Q.

COMMISSIONER LEMAN: Well, if we might come back to that later in another context. We will come back to that in another context, Mr. Chairman, with your permission.

I would like to ask one small question now. The Act now requires a minimum capital to start a chartered bank, but the Act doesn't have anything in it which has anything to do with the concept of adequate capital to debt ratios, and the capital structure of the bank. Would it be useful to indulge in a little discussion on whether there would be some merit in establishing such ratios? You could start with a capital of X, but there would be some kind of a curve or ratio of equity capital in the bank related to its liabilities.

MR. HACKETT: Is the suggestion, sir, that some formula governing capital ratio in relation to size would be an acceptable thing?

COMMISSIONER LEMAN: Or do you feel that any such concept is rendered unnecessary due to other provisions related to cash reserves and liquidity reserves?

MR. HACKETT: Yes, I think there is a certain automatic governor in these reserve requirements that would render the other concept rather redundant.

MR. WADSWORTH: I think you could add to that the close supervision and scrutiny given to the affairs of the bank on a continuing basis by the Inspector General.

COMMISSIONER LEMAN: But does the Inspector General go over your credits and analyze the credit-worthiness of the debtors?

MR. HACKETT: He examines them quite carefully.

COMMISSIONER BROWN: The trust companies are by legislation limited to accepting liabilities for a total of 12½ times their capital and other shareholder equity. The chartered banks at the moment are running at about 17 times. I am just looking at the list on page 148 of your brief, and I see that they vary. The Royal Bank shows 6.80 per cent which is approximately 16 times, and the Bank of Montreal is 5.70 and the Canadian Imperial Bank of Commerce is 6.07, so you see that you are running 16 and 17 times, and the Banque Provinciale is 4.76, so that is about 21 times.

MR. LORENZO HEBERT: May I say that our capital has been increased since that time; these figures are at 1961, I think, November of 1961.

COMMISSIONER BROWN: It was the simplest table for me to have access to. Yours has been increased so you are probably under the 20 mark?

MR. LORENZO HEBERT: Right. Instead of 19 it would be 25.

COMMISSIONER BROWN: I see. So, you are running just 16 times, a little more than 16 times. Now, if greater encouragement will be given to the forming of the near-banks into banks, the moment they operate or at least some of them do operate under this $12\frac{1}{2}$ times limitation, if you are all going to be put under the same sort of limitations, have you anything to suggest or any ideas to put forward on this?

MR. LORENZO HEBERT: That certainly would be one more rigidity in the banking system, apart from what we already have.

MR. WADSWORTH: Did I understand your question, Mr. Brown: Have we any suggestions to put forward as to what should be done in the case of trust companies?

COMMISSIONER BROWN: That is right. Should this 12½ times be removed as far as they are concerned?

MR. WADSWORTH: I think the answer hinges fairly largely on what final decisions are reached as to the actual functions of the so-called near banks. I think you would have to answer one with the other.

COMMISSIONER BROWN: I missed some of that answer.

MR. WADSWORTH: I am sorry. I think that the answer would rest on whatever the final decision, or whatever the views of the Commission and others might be as to the role of the near banks, and any requirements which might be placed upon them and upon the banks as far as reserve ratios are concerned, and other inspection techniques which might be involved if they were part of the banking system.

COMMISSIONER BROWN: One thing I should like to get an opinion on is this. My question is directed particularly to the smaller banks. Do you find any difficulties connected with size?

Do you find you cannot operate as closely to the 8 per cent cash basis as others? Are you subject to greater percentage ebbs and flows?

MR. LORENZO HEBERT: There might be problems every now and then, of course. The more branches you have, the more widespread is your network. You always have the law of average, of course. If you have more branches you may have a favourable balance in one centre and an unfavourable balance in another centre. The fewer branches you have, the swing might run against you for a day or two, but on the other hand so far as we are concerned we never had any particular trouble, not any more than the other banks. Of course, in periods when money is very scarce and the money supply is restricted, we would have the same trouble as the other banks.

COMMISSIONER BROWN: Have you any comments on this, Mr. Hebert?

MR. LOUIS HEBERT: No. After all, it is perhaps an advantage. If you are smaller your problems are smaller too.

COMMISSIONER BROWN: Now I see why the banks are worried. You do not have any problems?

MR. LOUIS HEBERT: No.

COMMISSIONER BROWN: You have no problems that are directly attributable to relative size?

MR. LOUIS HEBERT: No. We have the same problems as others, but no specific problems.

MR. LORENZO HEBERT: You are inquiring specifically in connection with the 8 per cent reserve?

COMMISSIONER BROWN: I am thinking of any problem that is particularly related to size.

MR. LORENZO HEBERT: Naturally there are some kinds of business that it would be more difficult for us to handle, such as very large borrowing accounts, but perhaps we have been very smart to have been able to hold our own so far.

COMMISSIONER BROWN: Good.

MR. BOND: I should like to say just a word on this, that being a small bank sometimes it is not always easy to get funds into the central bank the same day when drawings from foreign correspondents come through unexpectedly. Sometimes they do not put us in funds as they should do. They are well-known banks abroad, and one definitely cannot refuse to make the payments. Under such circumstances quite large swings can occur, and if they do the smaller banks are obliged to carry more short-term instruments, including more treasury bills, than the larger banks, to meet such drawings.

At the present time there is a difficulty in turning treasury bills into liquid cash the same day to meet such drawings as I have explained to you from correspondents, or orders of payments, and it would be extremely convenient, speaking for a small bank, if we could deal in funds on the same line, say, as federal funds are in New York, or on the Continent as we used to be able to exchange between one another.

Most Continental banks have a means of

exchanging right up to two o'clock in the afternoon, cheques on the Bank of France or the Bank of Italy, and in Germany day-to-day loans go through right up to the late afternoon, which both small and large banks can lodge, and you can attain and keep your ratio much closer than you could under our system.

COMMISSIONER BROWN: Two things are involved here. One is that the day's delay in getting the credits in your account in the Bank of Canada affects you relatively more than the others. The second point is: Does this arise particularly because of the large proportion of foreign business to your total business?

MR. BOND: No. We do not find drawings from Canadian customers as large in relation to their accounts as you do in running accounts with foreign banks.

COMMISSIONER LEMAN: Mr. Brown, I had a question, if we could go back for a second to the equity capital in a bank. Mr. Lorenzo Hebert has just referred to the fact, and logically enough, that a small bank probably cannot handle as large loans as a very large bank. As I understand it in the United States the banks are limited in the amount they can loan to any one account, and this limit is related to the size of their capital in reserve. As I understand it there is no such statutory limit here in Canada, but is it a practice among the banks to relate the size of loan they feel they can make to their capital in

reserve?

MR. MULHOLLAND: That is a matter of judgment for management in each bank, Mr. Leman, for sound judgment.

COMMISSIONER LEMAN: You have not observed any pattern which tends to be standard?

MR. MULHOLLAND: There is no yardstick, but that is in the area of individual judgment.

COMMISSIONER LEMAN: I was just coming back to the concept that you expressed a little earlier to the effect that what off-sets any necessity for having a ratio of equity to liabilities is the other ratios the banks have to observe -- cash ratio, liquid ratio, and so on -- and I am puzzled that despite the fact the United States banks also have these other ratios to observe, they also have to observe this extra one.

MR. LORENZO HEBERT: In the United States they have some fourteen thousand banks. A lot of them are very, very small ones, and a lot of them have a capital of only $10,000. It is very much more difficult, of course, to supervise a banking system where you have fourteen thousand banks than it is in Canada where you have only eight banks, all well known. The banks are known to everybody. This may be one of the reasons, I would imagine.

COMMISSIONER LEMAN: I have heard that even the very large United States banks have bumped their heads against that ceiling. You used that

MR. MACLEOD: That is a [illegible] market segment for management. In each case, Mr. Leman, [illegible] sound judgment.

COMMISSIONER LEMAN: [illegible] observed [illegible] the term which seems to be [illegible] [illegible]. There is no yardstick, but that is in the area of individual judgment.

COMMISSIONER LEMAN: I was just coming back to the concept that you expressed a little earlier to the effect that risk offsets [illegible] may necessarily [illegible] the ratio of equity to liabilities is the other factor the banks have to reserve -- contracts, liquid [illegible], and so on -- and I am puzzled [illegible] that the [illegible] also have [illegible], they also have to consider this element.

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States that have some [illegible]. A lot of [illegible] are very, very [illegible], and a lot of them have a capital of [illegible], is very much more [illegible] [illegible] [illegible] [illegible] you have [illegible] banks, all well known. [illegible] This [illegible], I would imagine.

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expression "bumped their heads against the ceiling" yesterday. I think perhaps they were glad they did. Perhaps in their judgment they were glad they were bumping their heads against the ceiling. I am referring to very large banks.

MR. BOYLES: Mr. Leman, I believe the banks have a sort of natural consciousness about getting too many eggs in one basket and there is a sort of automatic restriction here with the result you often find a consortium of banks accommodating a certain client who is in need of funds in a substantial quantity.

MR. BOND: If such a situation arises, Mr. Leman, I think it would be possible to arrange participation with another bank. That is what is frequently done in the United States.

COMMISSIONER LEMAN: That is what Mr. Boyles is referring to, a consortium of banks.

MR. BOND: Yes.

COMMISSIONER MACKINTOSH: More baskets for one egg.

COMMISSIONER BROWN: Under the Bank Act when a bank wishes to increase its capital it is limited in the price that can be placed on the shares for which rights are issued. It has been suggested that perhaps this rigidity or limitation should be removed and that the price which additional shares are issued at should be left to the judgment of the directors deciding on the issue. Have you any comments on this?

MR. MULHOLLAND: I believe I am safe in saying that we feel this should be the case. There are many factors involved, the most important of which is that it is a very costly way for the banks to raise additional capital.

COMMISSIONER LEMAN: If they do not have this freedom?

COMMISSIONER BROWN: This is, of course, only an apparent cost because it goes to their existing shareholders and the shareholders have an opportunity to participate in it.

MR. MULHOLLAND: That is right.

COMMISSIONER BROWN: So it is more of an apparent cost than a real cost.

MR. LORENZO HEBERT: One drawback, of course, is that if you get capital in this way, which is more costly, you may have to reduce the rate of your dividend and this may be misinterpreted by the public.

COMMISSIONER BROWN: That is a very good point. That is all I had on this.

THE CHAIRMAN: We shall adjourn until two o'clock.

--- Luncheon Adjournment.

--- The hearing resumed at 2 p.m.

THE CHAIRMAN: We shall now resume.

MR. MULHOLLAND: Mr. Chairman, may we please, with your permission, clarify a comment made this morning in the foreign currency business area?

THE CHAIRMAN: Yes.

MR. SHANNON: Mr. Chairman, this morning in dealing with the New York agency business I said that we could not take deposits from within the United States. I intended to say "within the state of New York". I should like to make that correction for the record.

MR. MULHOLLAND: Thank you.

COMMISSIONER MACKINTOSH: I have a couple of questions, Mr. Chairman, that I intended to ask this morning. I was clear enough that this foreign currency business was a highly competitive one which yielded what was thought an adequate income for the bank, and presumably an increase in the income of any taxpayer is a desirable public good.

Are there any other by-products which flow from this business? Has it a relationship to the development of trade or to the acquisition of long-term capital or anything else of this sort?

MR. SHANNON: I cannot think of any off-hand, Dr. Mackintosh. It puts the Canadian banks in the trading picture and in that way we are perhaps better able to serve the needs of our clients. As far as any other contributions to the economic good of Canada are concerned, I cannot think of any off-hand.

COMMISSIONER MACKINTOSH: Do you develop any experience in contacts which are of value in fields other than short-term investments?

MR. SHANNON: Yes. We are in contact with European banks and the London banksand it keeps us in the market picture. As an international bank you are either in the market picture or you are not.

COMMISSIONER MACKINTOSH: Does it give you a contact with foreign firms which might establish plants or offices in Canada?

MR. SHANNON: Yes, I would say it does. The bank that establishes these contacts with foreign concerns is the bank which these foreign concerns would be thinking about when coming to Canada to do business. So it has this advantage of business development.

COMMISSIONER MACKINTOSH: Are there any contingent liabilities in connection with this business that are of significance?

MR. SHANNON: It is a straight matter of taking deposits and investing money. We keep liquid so we think we can meet any demands that might be made if there was a constant change in conditions and a lot of these deposits were to go down. I can think of no other contingent liabilities which might arise from it.

COMMISSIONER MACKINTOSH: You, so to speak, provide your own liquidity out of the assets that you acquire?

MR. SHANNON: Exactly.

COMMISSIONER MACKINTOSH: That is all I have.

COMMISSIONER McKINNON: Do you develop any experience in contacts which are of value in this [illegible]

MR. SHANNON: Yes. We are in contact with European banks and the London market in Europe and in the market picture. As an international bank you are either in the market picture or you are not.

COMMISSIONER McKINNON: Does it give you a contact with foreign firms which might establish plants or offices in Canada?

MR. SIMMONS: Yes, I would say it does. The bank that establishes these contacts with foreign concerns is the bank which these foreign concerns would be thinking about when coming to Canada to do business. So it has this advantage of business development.

COMMISSIONER McKINNON: Are there any contingent liabilities in connection with this business that are of significance?

MR. SIMMONS: It is a straight matter of taking deposits and investing money. We keep liquid so we think we can meet any demands that might be made if there was a constant change in conditions and a lot of these deposits have to go back. I can think of no other contingent liabilities which might arise from it.

COMMISSIONER MacINTOSH: Just, so to speak, you practise your own liquidity out of the sources that you [illegible]

MR. SIMMONS: Exactly.

on this subject.

MR. LORENZO HEBERT: Mr. Chairman, before you pass to another subject may I say Mr. Harris, who had to leave hurriedly at noon, requested me to make a short statement on his behalf. He stated this morning that orders drawn on near-banks were not bills of exchange. What he had intended to say was that they are not cheques as defined in the Bills of Exchange Act. I was requested to make this statement for the record.

COMMISSIONER MACKINTOSH: If I could add another question: In the past in some countries certain eventualities, if not liabilities, have occurred which have affected the Canadian banks. Is this a consideration for the future?

MR. SHANNON: What did you have in mind, Dr. Mackintosh?

COMMISSIONER MACKINTOSH: Oh, Cuba would do for an example.

MR. SHANNON: You mean strictly foreign business not taking foreign deposits.

COMMISSIONER MACKINTOSH: Yes.

MR. SHANNON: Well, that is a risk you take in doing business in those countries. The rate of return is commensurate with the risk.

COMMISSIONER LEMAN: It is safer in the States?

MR. SHANNON: Exactly. I do not think any of the banks lost anything in Cuba. We lost our business in the continuing flow of profit from Cuba, but we did not lose anything as far as actual

transactions were concerned.

COMMISSIONER BROWN: I wonder if I could take this opportunity to ask Mr. Shannon a follow-up question to his voluntary answer? He said he wanted to be explicit that he did not take deposits in the State of New York. Why did you make this statement, Mr. Shannon?

MR. SHANNON: I said this morning, Mr. Brown, that as part of our conditions under which we operate in the New York agency, one condition was we were not permitted by the New York banking authorities to take deposits -- and I said, "within the United States", but I meant, within the state of New York.

COMMISSIONER BROWN: So the implication now is that you do take deposits in the United States but not in the state of New York. Would you follow that up?

MR. SHANNON: We do business with corporations outside of New York State.

COMMISSIONER BROWN: Do you have any reserve requirements against those deposits?

MR. SHANNON: No, we are not required to, by the New York State banking authorities.

COMMISSIONER LEMAN: I have a question I did not ask this morning when we were discussing the payments and clearing system. I have now got hold of the figures that Mr. Wadsworth referred to, and one of the points that the near banks have made with us in the context of the argument is that some of them, at least, perhaps more than others, do negotiate a lot of orders drawn on banks; they are negotiated in their premises. When you consider the offset of cost to revenues from the charges you make to these institutions, do you take this into account?

MR. LORENZO HEBERT: I think I know what

you mean, but I wonder if you would clarify it a little bit.

COMMISSIONER LEMAN: We are trying to get an idea of how this nets out, the charges made to these institutions against the offsetting cost of doing the clearing for them. Does the banking system as a whole take into account the fact there are quite a lot of instruments negotiated at the near banks which are drawn on banks for which they made no charges?

MR. LORENZO HEBERT: We would be very glad to negotiate these cheques ourselves, of course. We are in the banking business, and we have a system of branches throughout Canada. We are in a position to serve almost everybody, and these cheques could be easily negotiated at our various branches. So far as we are concerned they are customers of the banks, and we try to make for them about the same conditions as we make for our other customers, except that since these items are handled in bulk the rates we grant them are much finer than those granted to our ordinary customers.

COMMISSIONER LEMAN: Are not you now speaking only specifically of your relationship with the Caisses Populaires?

MR. LORENZO HEBERT: It is the same with everyone; it is the same relationship. The only difference with the others is that instead of having an account with each bank at a central point they have an account with us. That is the

only difference, and the conditions are the same.

COMMISSIONER LEMAN: Do not they incur some costs in the negotiation of instruments on their premises?

MR. LORENZO HEBERT: Yes. Maybe I could better illustrate that in another way, if you do not mind. I suppose that a company like the C.P.R., which issues a large number of cheques -- or instead of the C.P.R. let us say any company -- they issue a large number of cheques and, on the other hand, they receive thousands of cheques from their customers. If they came to us and said, "Well, we collect thousands of cheques and we bring them to you and, on the other hand, we issue a large number of cheques, why not just clear one against the other without any charge?" We could not, of course, because we are not in the same line of business and we have our systems that we have set up which they do not have, and the conditions for those near banks is in some way the same. The banks consider they are customers, and if they take the cheques that could easily come within the banking system -- and it is up to them, of course -- the banks do not see why they should go out of their way just to facilitate this.

COMMISSIONER LEMAN: There was another point we discussed this morning, to which I would like to revert for a minute. The banks indicated to us the cost to them of handling government business, for which they do not feel compensated,

though you said you did allow for the partial compensation you get through deposits from the government. Up to now I think the government has always argued this was quite right, that this was a normal service the banking system could provide for the government. Could we discuss this principle a little more? Is there anything you want to add to complete the picture on this?

MR. BOYLES: Not very much, Mr. Leman, except from this viewpoint, that, after all, we are federal corporations and we are taxpayers and we have never felt there was full justification for the unwillingness -- let us put it this way -- to compensate the banks for their unrecovered costs. In other words, you might even suggest this is another form of taxation.

COMMISSIONER LEMAN: Unequal taxation. In other words, they are not spreading the cost of the service over everybody in the country equally?

MR. BOYLES: We have never suggested we should handle this business on the basis of having a profit; but all we have sought is a return of our out-of-pocket expenses.

COMMISSIONER MACKINTOSH: Somebody pays for it. Does this mean it is, in effect, spread over the other customers of the banks?

MR. BOYLES: Very definitely. It goes to reduce our profits which is tantamount to the same thing, and returns to shareholders, and so on.

COMMISSIONER MACKINTOSH: With the view I have had of the very active competition amongst the banks, that is not the likely outcome, is it?

COMMISSIONER BROWN: I would like to ask another question relative to competition. A view has been expressed several times that you would not mind facing further competition, provided it is on a fair and equal basis. Canadian banks are able to operate in foreign countries, either directly or through agencies. What is the reason why foreign banks are not permitted to operate in Canada? What are the reasons against them operating in Canada as banks or bank agencies?

MR. SHANNON: Some of the New York banks do in fact operate in Canada due to the closeness of the market. Many call on our clients here and do business deals with them.

COMMISSIONER BROWN: Are they as big a factor here as you are in New York?

MR. SHANNON: We have an agency in New York and we are not taking deposits from New York clients.

COMMISSIONER BROWN: But you maintain an office in New York?

MR. SHANNON: Yes, we maintain an office in New York, and there is no reason why they could not come within the Bank Act here, except that our system has branches. They would not be in a position on an equal basis unless they

did build up their system of branches, which would be costly.

COMMISSIONER BROWN: Do I gather from your remarks that there is nothing that would stop them operating as a bank under the Bank Act?

MR. SHANNON: If they complied with the requirements of the Bank Act and were granted a charter, there is no reason why they could not.

COMMISSIONER BROWN: Has anybody any idea why none of them has done so?

MR. SHANNON: I think this very point, they would have to build up a system of branches to be really competitive in Canada, and it would be very costly.

COMMISSIONER BROWN: You have not found it necessary to build up a system of branches in the United States?

MR. SHANNON: In New York they have branches within the city, but we are not doing local business there.

MR. BOND: New York is a big financial centre, there is a lot of business to be got; but Montreal and Toronto are much smaller and are like provincial cities to the Americans, and there is not that large proportion of business to be got. It is the question of where the market is and the profits to be made.

COMMISSIONER BROWN: They have not come up here because there is not the profit to be made?

MR. BOND: Yes, I think so.

THE CHAIRMAN: Do all the members of the Association agree with that?

MR. WADSWORTH: I do not know about the terminology, but we all know that New York is a very important international financial centre, and there is a great amount of business transacted there that has no relationship to the state of New York.

COMMISSIONER BROWN: Yesterday we had a short discussion about cash reserves and 8 per cent. If I recall correctly, I think the answer was given that there was a certain difference of opinion. Some banks considered the 8 per cent adequate; others thought it was probably about the right figure; and still others had a different idea. Again flying the kite, if the 8 per cent were reduced, say, to 6 per cent, would you work to 6 per cent? Would you all work to 6 per cent?

MR. NEAPOLE: We would have to, would we not?

COMMISSIONER BROWN: Would you have to work down to 6 per cent?

MR. NEAPOLE: Do you mean if it were written into the Bank Act?

COMMISSIONER BROWN: No.

MR. NEAPOLE: That is a moot point. I would say we would.

MR. MULHOLLAND: The same incentive would exist to work as closely as possible to any

cash ratio established, because it would be unprofitable to do otherwise.

COMMISSIONER BROWN: What about 5 per cent?

MR. MULHOLLAND: I cannot speak for all the banks.

COMMISSIONER BROWN: No, but the individual bank?

MR. MULHOLLAND: I would try.

COMMISSIONER BROWN: What about 4 per cent?

COMMISSIONER LEMAN: How far down would you follow Mr. Brown?

COMMISSIONER BROWN: This is a Dutch auction!

MR. MULHOLLAND: I do not know what par for this course is! I would venture this observation though, that I think the further down you get in the absolute scale, one of the questions that one increasingly has to bear in mind is the "get-at-ability" of secondary reserves right above that ratio. I speak subject to some correction here -- and, perhaps, subject to a lot of correction -- but I think there are one or two European banking systems which work to exceedingly low cash ratios, but place a much greater emphasis on sight money, perhaps employed in near-by markets that they can get at very quickly. In that context the cash reserve becomes almost a means of meeting clearing losses rather than a basic reserve.

COMMISSIONER BROWN: If it were reduced and there was a difference of opinion as to how close people were going to operate to this reduced level, it provides more difficulty for the money managers in the Bank of Canada.

MR. MULHOLLAND: That would be so.

COMMISSIONER BROWN: In knowing what the reaction would be throughout the system. Therefore, they have to operate at the highest level at which any bank would want to operate.

MR. MULHOLLAND: I would agree you need a conventional agreement or approval that the rate was fixed at a reasonable rate, and that the rate established did not involve any marked divergence of philosophy, almost.

COMMISSIONER BROWN: Among the members of the system?

MR. MULHOLLAND: That is right.

MR. LORENZO HEBERT: The banks, of course, have to carry till money to a very large amount, and the balance of the Bank of Canada is only part of our reserve, and we could not go too low as a matter of day-to-day operation.

COMMISSIONER BROWN: The point I wanted to bring out was, in order for the cash management of the Bank of Canada, they would almost have to have an agreed level to which everybody worked as closely as possible.

MR. MULHOLLAND: That is right, sir.

COMMISSIONER LEMAN: Does Mr. Bond have any comment on this?

MR. BOND: No. I would think it would be as easy to work at a level of 8 per cent, as they did in London, as at 7 per cent, if that is the question.

COMMISSIONER BROWN: We are talking purely of the rate, whether the 8 per cent should be reduced to 7 per cent or 6 per cent.

MR. BOND: I do not think I would have any comments to make on that.

COMMISSIONER BROWN: Mr. Chairman, before we go on to another subject I have a further point of clarification I would like. I think Mr. Harrold asked this morning about loan authorizations for corporations that were represented on the bank boards by a director of a borrowing corporation. I think the answer was given that this was covered in a report made to the government. Is this report a dollar figure or the names of the corporations involved?

MR. WADSWORTH: It is a dollar figure.

COMMISSIONER BROWN: Of the various loans?

MR. WADSWORTH: Yes, that is right. These are reported monthly.

COMMISSIONER BROWN: Could you ask the requisite authority that these be made available to us? There seems to be a little difference of opinion as to whether it is a dollar figure or a names

report.

MR. CROWE: It is a dollar figure, and it is required under the Bank Act.

COMMISSIONER BROWN: That is fine, thank you very much.

MR. WHIPP: Under Schedule M of the Bank Act. This is on page 87, if your act is similar to mine.

COMMISSIONER BROWN: I hope we are all working on the same act!

MR. WHIPP: It is at the back, under Schedule M, right at the bottom, "Supplementary information".

COMMISSIONER BROWN: This does not give a complete answer.

MR. WHIPP: You asked, what was the dollar amount?

COMMISSIONER BROWN: Of the authorized loans.

MR. WHIPP: The aggregate amount?

COMMISSIONER BROWN: This is the aggregate amount of the loans?

MR. WHIPP: To the directors.

COMMISSIONER BROWN: I asked for the aggregate authorization.

MR. MULHOLLAND: The authorized credits.

COMMISSIONER BROWN: Yes.

MR. WADSWORTH: I misunderstood your question.

COMMISSIONER BROWN: Could this be made available?

MR. WHIPP: It certainly can be obtained.

COMMISSIONER BROWN: We would like to have it. Thank you very much.

THE CHAIRMAN: The next subject is the inner reserves of the chartered banks. As I understand it, it has been for many years public policy to provide for certain hidden reserves, the amounts of which are not to be disclosed to the public, and certain of those reserves are not subject to income tax. Therefore, in the discussion I assume it would be inappropriate to discuss any figures as to the amounts of reserves of any particular bank, and that we should confine ourselves to a discussion of some of the issues involved.

There is one exception, however. In the

submission of the Inspector General it is stated -- and this, of course, is public property -- that the chartered banks as a whole are permitted contingency reserves at the 1962 fiscal year, amounting in the aggregate to $326 million or 2.951 per cent of related assets after the deduction of specific reserves from maximum reserves allowed, that formula in use -- and it covers both specific and tax-free reserves -- would produce for the fiscal year 1963 a maximum reserve percentage of 3.504 per cent.

Now, aside from those two items the discussion could, I think, deal with the broad issues involved and the justification for the continuation of the policy, and the adequacy of the provisions for reserves. There is also the question of justification for continuing the secrecy attached to these reserves and the tax exemptions now provided for.

I suggest, Mr. Mulholland, that you might begin by giving us an outline of the position generally and what are the views of your association. This matter is referred to in your brief in sections 348 to 359.

MR. MULHOLLAND: I assume, Mr. Chairman, you do not wish me to make any reference to these paragraphs you have mentioned?

THE CHAIRMAN: No. We have all read them. It is just to put forward your views and to give us a certain amount of background, and perhaps to emphasize some of these points.

MR. MULHOLLAND: I will open this subject,

Mr. Chairman, but I should perhaps preface my remarks by saying that the matter of the formula for calculating the inner reserve figure is a matter which is in constant review with the Minister of Finance and his representative the Inspector General. The conversations are going on even at the present time, and have been over the last year or so, in relation to this formula. It is a matter which is resolved from time to time between the Minister and the banks.

Insofar as the concept of the inner reserves is concerned, if you wish me to mention that before we get too deeply into the subject, I shall do so. These reserves merely act as a pool by which a certain portion of earnings during a period of good times may be set aside to meet losses which invariably occur during a cycle of poor years.

Prudent bankers recognize that in valuing their assets at any given date, adequate provision must be set up for known losses at that particular date, as well as those for which there may be some losses against loans on which there may be some apprehension in the minds of management but which at that specific date have not been readily identified.

On behalf of the Association I may say that the banks' views on this general concept of inner reserves were clearly stated by the Minister of Finance during the 1944 Bank Act revision proceedings. I shall not quote from that, Mr. Chairman, unless you wish me to do so, because I am sure you have it in your records. As to the present method of calculating

reserves, I suppose you also have that information, but I would be glad to put it in the record in very brief form.

THE CHAIRMAN: It is all in the Inspector General's brief, and I don't think it is necessary to put it on the record here in any detail.

MR. BOYLES: Mr. Chairman, as Mr. Mulholland has so aptly described the concept of inner reserves, may I just add that this is also quite well described in our brief to the Commission.

In addition to what Mr. Mulholland has said, I think the main point is that no commercial bank would be fulfilling its obligation to its depositers or to the community if adequate steps, as suggested by Mr. Mulholland, were not taken.

I understand that you are well acquainted with this prescribed formula through which the allowable reserve is computed. It is rather interesting to note the effect of that formula. If one were to have before him the banks' figures from 1953 to 1962, it would appear that the par or the allowable for general contingent reserve has remained virtually constant. I need not mention the figures here, except to say that the allowable is virtually constant, notwithstanding which the aggregate assets of the bank in 1953 were approximately $5 billion, whereas at the end of 1962 the respective figure was something to the order of $11 billion.

This rather points to what we think to be the inadequacy of the formula, and of course, it

develops from this main point that the banks are replacing low average assets and relatively high loss experience by high average assets and low loss experience.

I do not believe I need go into the details of how that works, because you do have the formula before you. But I suggest, sir, that this matter of reserve formula requires some revision in the interest of the banks and, of course, through them for the purpose of protecting depositers.

As you know, starting in perhaps 1929, and through the early thirties, we went through a long period of unhealthy economic conditions which naturally gave rise to severe losses. It is in that era that we have extracted, in accordance with the prescribed terms of the formula, a figure representing the loss experience of the bank. We are now moving out of that era into a more favourable period in respect of which the loss experience was not so great. Now we are looking into another cycle: we have larger risk assets, and it is only reasonable to assume that because of the relatively free and easy way in which the banks operate in respect of credits during good times, that some of the results will catch up with us in the years to come. Therefore, it is only prudent for us to suggest that we should take action to have appropriate reserves to provide for this contingency.

In addition there is, of course, always the need in the course of making loans to set up specific reserves for losses that are already established. Under the present prescribed formula these specifics are all

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part of the overall par. We suggest that there should be sufficient allowance for the specifics and additional reserves for that purpose, and that there should be a contingent reserve or an inner reserve to provide for the unknown, for the things that may develop with experience.

THE CHAIRMAN: There is no limit to the amount of reserves you may set up, is there? There is only a limit to the amount of reserves that you may set up tax-free?

MR. BOYLES: Right.

THE CHAIRMAN: And in addition to that you may set up more reserves, if you think it advisable, and pay taxes on them.

MR. BOYLES: Yes - that is when there is enough available. On the other hand, I think it is fair to say in respect of taxes that you might regard a transfer to inner reserves before taxation as a deferred tax, to some extent. In other words, in the event that we find such reserves get beyond the allowable, they are indeed brought back into taxable income.

THE CHAIRMAN: But you get the use of the money interest-free during the interim, don't you?

MR. BOYLES: Yes.

COMMISSIONER LEMAN: Mr. Boyles, in discussing this subject, is it not true that in order to change the formula or make greater amounts of tax-free inner reserves available to the bank, one would have to form a judgment as to their adequacy with regard to the period or the new cycle the banks are now coming

into. I understand that was your explanation?

MR. BOYLES: Yes.

COMMMSSIONER LEMAN: Could you suggest to us how one would go about judging their adequacy? You can't work to a vague amount; you have to work to some precise amount.

MR. BOYLES: Exactly - except that one goes on the basis of experience in the past. In other words, we know what our loss experience was over the past many years of good and bad times; but under this present arrangement we are working on the basis of loss experience of what were relatively good years for the banks. This prompts us to suggest that the formula is not truly adequate.

COMMISSIONER LEMAN: What would be an adequate formula?

THE CHAIRMAN: Out of those good years would you not have been able, if you had decided it was prudent to do so, to set aside more reserves than you did? Apparently you did not think that was necessary?

MR. BOYLES: First of all, Mr. Chairman, one has to relate such transfers to the availability of funds after paying your bills and your taxes. You will find generally in the less favourable years -- and this relates to my first point - you do not have that opportunity. In the more favourable years it is prudent to add to your contingency reserves.

COMMISSIONER LEMAN: "Bigger reserves" is also big, is it not? What would be a good formula?

MR. BOYLES: May I emphasize again the degree

to which the risk assets of the bank have increased, even in that period from 1953 to 1962. Actually, they have more than doubled. This naturally suggests that we have to keep pace with this trend in our risk assets, and I suggest that the present formula does not permit us to do that.

COMMISSIONER LEMAN: I am wondering if you could give me the guiding principle of arriving at a good formula?

MR. BOYLES: I know your point, Mr. Leman, and I suggest to you that it is not easy because in effect we don't know the unknown. However, we think it is prudent to suggest that we should not be operating under a formula which can permit us to set aside less each year as the result of the application of the formula which is now based on the experience in the more favourable years.

COMMISSIONER LEMAN: That is a negative principle. How about some positive principles?

MR. BOYLES: Would you like me to suggest how much we should be allowed?

COMMISSIONER LEMAN: I am not suggesting that you give us a precise answer. I am just asking you to give me the guiding principle. What are the factors you would take into account and how much weight would you give to them? What would be your approach to judging the adequacy of the reserve?

MR. BOYLES: Number one is the loss experience in the worse years as related to the respective risk assets of those years.

COMMISSIONER BROWN: Are you suggesting that you would be satisfied with a reserve equivalent to the percentage loss ratio in one year?

MR. BOYLES: No, not necessarily. For instance, in the United States they permit them to pick out 20 consecutive years from 1927, representing the worse loss experience.

COMMISSIONER BROWN: And how many years loss are you allowed to carry? Is it a three-year loss ratio?

MR. BOYLES: This is a contingent reserve.

COMMISSIONER BROWN: Yes - in the American system.

MR. BOYLES: The basis there is the loss experience in any twenty consecutive years since 1927.

COMMISSIONER BROWN: But presumably they are not allowed to set aside the total of the twenty years, are they?

MR. BOYLES: No.

COMMISSIONER BROWN: How many years are they allowed? Is it not three years?

MR. BOYLES: Yes, that is quite right.

THE CHAIRMAN: The worst three years in the twenty? Three times the average?

MR. BOYLES: That is right, three times the average.

COMMISSIONER BROWN: How would that relate to the present Canadian situation?

MR. BOYLES: I can't answer that question.

COMMISSIONER BROWN: It would be relevant,

wouldn't it?

MR. BOYLES: It would be.

COMMISSIONER BROWN: But you can't tell me whether it would be higher or lower than the present Canadian situation?

MR. BOYLES: No. I do not have any statistics concerning the loss situation.

COMMISSIONER BROWN: I am saying, if you took the twenty worst years in the Canadian experience, and then took the worst three of the twenty, how would that relate to your average?

MR. BOYLES: It would probably be all right as of today, but we are thinking of the downward trend that is produced by this formula.

THE CHAIRMAN: The trend over the last period in the calculation of reserves has, on the whole, been going up. The losses have been small, and there hasn't been any concentrated period when you had any heavy losses.

MR. BOYLES: That is right.

THE CHAIRMAN: That is the situation, once the formula moved forward and away from the depression years.

MR. BOYLES: Yes.

THE CHAIRMAN: So, the net result of it is that the amount of the reserves you are allowed under this formula are going down every year?

MR. BOYLES: That is quite right, and at the same time our risk assets are going up.

THE CHAIRMAN: You never know whether in the next three, four or five years you may get another heavy loan period.

MR. BOYLES: Yes.

THE CHAIRMAN: And by that time you will have less reserves than you had at the beginning of the year?

MR. BOYLES: Yes.

THE CHAIRMAN: That is your position?

MR. BOYLES: Yes.

THE CHAIRMAN: And for that reason you say that this formula is not appropriate?

MR. BOYLES: Quite.

THE CHAIRMAN: But I don't know whether the alternatives that you suggest, whether that cures the situation.

MR. BOYLES: You mean in just making a comparison with that permitted in the U.S.?

THE CHAIRMAN: Yes.

MR. BOYLES: I am not suggesting, sir, that it does; this is something that we are studying.

THE CHAIRMAN: Is there any formula similar to it and based on the present formula? In other words, is the basis of that formula adequate? Is that the right type of formula to have at all?

MR. BOYLES: I believe that there is merit in this type of formula provided that it is realistic in respect to the contingencies.

THE CHAIRMAN: Apparently it is not, though, from what you say.

MR. BOYLES: Yes, exactly. What I am trying to say, sir, is that on the basis that certain percentages must specify type of assets, this does seem to be reasonable, but when one is restricted in the amount of allowables, notwithstanding that it is percentage allowables, then you can see that the trend can move if there was a rise, but if it is based on the other experience, the loss experienced over a 25 year period, that is a moving 25 year period.

COMMISSIONER LEMAN: This bears some relationship to what we talked about this morning on the ratio of equity capital to liability, does it?

MR. BOYLES: I don't believe it does, sir. It may. I never thought of it in that context.

THE CHAIRMAN: It is what I understood you had in mind a moment ago, that these tax-free reserves in any bank might be drawn upon at any given time and moved into the balance sheet to offset some special loss that occurs, then that portion of the reserves would be subject to tax?

MR. BOYLES: The transfer out?

THE CHAIRMAN: The transfer out.

MR. BOYLES: Well, if it is a non-tax reserve, yes sir.

THE CHAIRMAN: If there is a loss; if in this case it was to take care of a loss, so that it would not be taxable.

MR. BOYLES: Oh, I see. In that event, no. If it was just --

THE CHAIRMAN: If it were just moved up, it

would be quite legitimate to move it up?

MR. BOYLES: Yes.

THE CHAIRMAN: Whether there was a loss or not?

MR. BOYLES: Yes.

THE CHAIRMAN: But if it was moved up and there was no loss, then it would be taxable?

MR. BOYLES: Right.

COMMISSIONER BROWN: Could I ask a further question for clarification of this? I think it was your point that you can put more reserves in there now providing you pay income tax on them, and I gather that you are also making the point that the present formula is not generous enough and that you feel the reserves should be higher than they are. If you feel the reserves should be X dollars higher than they are, at least you could put half X dollars into there, but has anybody done this; do you do it?

MR. BOYLES: Yes.

MR. NEAPOLE: Some banks do.

COMMISSIONER BROWN: Are the banks doing this as a principle in order to make absolutely clear that this is not a high enough reserve?

MR. BOYLES: There are transfers from time to time.

MR. WADSWORTH: In addition to what we may put into our contingency reserve if we don't feel that is adequate, are we putting additional reserves into a tax paid reserve, is that it?

COMMISSIONER BROWN: Yes; that is surely the

strongest argument you can give to any authority that you don't think the formula is satisfactory?

MR. BOYLES: I think probably this is followed by the banks to varying degrees but, as you would appreciate, if you were to absorb a loss out of a tax paid reserve it is a lot different, because you have had to put in twice so as to make it sufficient to absorb the loss. In other words, to pay the loss out of a tax paid reserve is costing you twice as much as if you paid it out of the tax-free reserve.

COMMISSIONER BROWN: At some stage surely there is a tax recovery?

MR. BOYLES: Yes, there can be.

COMMISSIONER LEMAN: Were there any transfers out of tax-free reserves by the banks as a whole in recent years?

MR. NEAPOLE: Very definitely.

COMMISSIONER LEMAN: Why would there have been if the general opinion is that the tax-free reserves were inadequate?

MR. BOYLES: There have been transfers out.

MR. NEAPOLE: I am not so sure I can answer that by saying that they felt the reserve was inadequate, but let us say that it was a question of judgment as to what should be done at the time. For instance, we transferred $10 million out at the end of 1961 and paid a corresponding amount of tax on it.

MR. WADSWORTH: Another reason, Mr. Leman, why we occasionally turn to our experience in this field.

COMMISSIONER LEMAN: It may be too naive an approach.

MR. WADSWORTH: No, but as you can appreciate, as the formula comes down it is quite inconceivable that the amount you have reserved may be higher than permitted by the formula and you may have to make certain transfers out.

COMMISSIONER LEMAN: The transfers out were forced?

MR. WADSWORTH: They could have been.

COMMISSIONER BROWN: Or you could have left them and paid the tax?

MR. WADSWORTH: Yes, it is a matter of choice of the individual banks and could vary.

THE CHAIRMAN: I gather from what you say up to this point that in fact the tax-free reserves are merely partly tax-free in a sense?

MR. WADSWORTH: That is quite right.

THE CHAIRMAN: That they are held there and subject to tax in any particular year until they are moved up out of that tax-free area and used for some purpose that is not for the purpose of off-setting some loss.

MR. WADSWORTH: That is quite right.

THE CHAIRMAN: And then it becomes taxable and it is taxed?

MR. WADSWORTH: That is right.

THE CHAIRMAN: And all the other reserves that are being accumulated, the tax-free reserves, they stand there and they are always subject to that whenever

they become used for other than paying losses, for other purposes than paying losses?

MR. WADSWORTH: That is right, so that there is no avoidance of taxes; there can be a deferment of taxes.

THE CHAIRMAN: Isn't it theoretical, at any rate, that they may all be used either to pay off losses or to be brought into the ordinary balance sheet of the company and then they would be taxed on that?

MR. WADSWORTH: That is quite right.

THE CHAIRMAN: And the main advantage, financial advantage you get from holding these reserves in this way is that you do have the interest on the money?

MR. WADSWORTH: But I would suggest if they were all brought out or published, and you had no cushion or no reserve, it wouldn't be too comfortable a position for a banker to be in in operating a bank because I think one of the most important points or one of the important points in addition to providing for losses -- and I believe we have brought this out in the brief -- is that at the bottom of the business cycle when you probably absorb some fairly substantial losses, it may be a very proper time for banks to take more than the normal risks they ordinarily would. Thinking that the economy is going to pick up and without any further reserves or so-called reserves, I think that in the interests of depositers and shareholders you would be much more careful in your approach than you would if you felt you had nothing to come and go on?

THE CHAIRMAN: Apparently the answer to what you claim to be the necessity of this type of reserve -- tax-free for the time being, at any rate -- is that it is necessary because of the peculiar nature of the banking business, is that so?

MR. WADSWORTH: That is right.

THE CHAIRMAN: Because the banking business is unique in this respect, is it not?

COMMISSIONER BROWN: There are other businesses that do have losses, sir!

THE CHAIRMAN: But do they have tax-free reserves?

MR. WADSWORTH: They probably have inventory reserves.

THE CHAIRMAN: Well, other businesses may be similar in some degree in this respect, but the banks have something on the face of it that looks like a rather special concession.

MR. WADSWORTH: That is right.

THE CHAIRMAN: And that must be for some reason applicable to the special nature of the business. What is the special nature of the business that justifies this particular situation?

MR. LORENZO HEBERT: May I venture something? One of the reasons, of course, is that the banks operate at a very thin margin of profit.

THE CHAIRMAN: And so does everybody else, from what they tell me!

MR. LORENZO HEBERT: I mean, we have agreed that it is as low as three per cent and there is a ceiling

of 6 per cent and when the end of the year comes, of course, it is very hard when you have thousands and thousands and thousands of loans on your books to say exactly that on this loan we are likely to lose 2 per cent and on this one we are likely to lose 5 per cent. We know some of them, of course, we make a specific reserve for those, but it would be very hard to put against each item the amount we are likely to lose or that we might lose if conditions were to change.

In an industry or in a store it is much easier, of course, to appreciate it; you can see these goods, these raw materials and it is much easier to say what their true value is likely to be next year or next month.

MR. BOYLES: The other point if I make it, is that I think it is generally recognized that a sound banking system is vital to the needs of the nation, and that if a bank is to give proper recognition to this, that we must take a certain amount of risk and also to act in a fashion that will not disturb the public confidence in the banks.

MR. WADSWORTH: To get back to your question, Mr. Chairman, another point which I am sure you are aware of is that the monies with which we are taking these risks, taking the management responsibility for these risks, are public funds; they are not individual shareholders' equity as they would be in some businesses. These are the deposits of many, many people, and for that reason we think that is another special thing.

THE CHAIRMAN: There are other financial

institutions that take public money.

MR. WADSWORTH: Yes.

THE CHAIRMAN: But do they have the same type of tax-free reserve situation? Insurance companies, trust companies and all sorts of near-banks are taking in public money, but as far as I know they pay taxes on reserves in the ordinary way.

MR. WADSWORTH: It may be, though, that more of their assets -- and I am not admitting they are not subject to some loss -- are more substantially secured as against the volume of loans, and we were discussing those a day or two ago that are for working capital purposes. The main security is the future of the business and the economic climate in which that business is operating.

COMMISSIONER LEMAN: Mr. Boyles didn't agree with me when I said I thought that there was some relevancy between that and the discussion this morning about the capital of the banks -- and you can't discuss this bank by bank -- but there is over a billion dollars of bank capital, isn't there, which is a fairly good sum of money for the absorption of losses as far as the depositers are concerned?

MR. WADSWORTH: Yes. I think, though, there is another factor that was mentioned; we don't wish to read it now, but it was a statement made by the Minister of Finance in 1944. It is the matter of public confidence and there are swings in the contingency reserve losses that may occur, but if these were all reflected in the public figures they could be at times

[illegible]

[illegible]

THE CHAIRMAN: [illegible] they [illegible] the [illegible]
of the [illegible] trust companies and [illegible] of [illegible] in [illegible] money. [illegible] I think [illegible] [illegible].

[illegible]

[illegible]
and I am not [illegible] in some [illegible] -- [illegible] of course, and we were [illegible] a day or [illegible] that are for [illegible] in the future of [illegible] to which that [illegible].

[illegible] with me [illegible] I [illegible] between [illegible] capital of [illegible] of them -- but [illegible] 2 [illegible]

MR. [illegible] in [illegible] wish to [illegible] the Minister of [illegible]

[illegible]

misinterpreted as to what is happening to the affairs of the individual banks or bankers.

THE CHAIRMAN: We haven't come to that aspect of it, but I am under the impression that there was some provision applicable to mortgage companies where some similar type of reserve -- perhaps on a smaller scale -- is provided. Are you familiar with that? There is a tax-free principle involved to some extent.

MR. NEAPOLE: Isn't it safe to say that any company is allowed to set up reserves of some kind and in some degree on which they do not pay taxes against book debts and inventory and so forth?

THE CHAIRMAN: Yes, but ---

MR. NEAPOLE: And other institutions, such as the trust companies and near-banks, and so forth?

THE CHAIRMAN: Yes, but I am not familiar with how it compares with this; this was considered as being somewhat special.

COMMISSIONER LEMAN: I know there is a general pool reserve --

THE CHAIRMAN: It is specific.

MR. PATON: I think the life insurance companies, Mr. Chairman, have substantial policy reserves; I don't know on what basis they are established, but I could well imagine that there is a contingency reserve included. In their annual statements you will find that.

THE CHAIRMAN: Do you know anything about the tax-free element in it; whether it is the same

principle as this?

COMMISSIONER MACKINTOSH: It would affect their tax position because they are taxed on their premium income and not on their profits.

Could I approach this from a little different direction. In one or two respects there is some analogy between this reserve and depreciation reserves in that I think they are both based on the assumption that a year to year calculation of income cannot be readily made because there are possible contingencies in the future.

Now, for depreciation there are allowances on varying rates that give the taxpayer some choice, and my impression is that their auditors to a very considerable extent have insisted that they set up reserves for future tax liability because they have taken advantage of these higher depreciation rates in the earlier years of the life of the asset. Has any shareholder's auditor suggested to the bank it ought to set up reserves for future tax liability? Could you take that?

[illegible] I [illegible]

[illegible] were [illegible] and not in the [illegible]

Could I suggest that [illegible]

In one or two [illegible] of [illegible] similarly between [illegible] in that I would [illegible] [illegible] a year in [illegible] in the future.

Now, for [illegible] on various [illegible] and my impression in that [illegible] considerable extent [illegible] [illegible] in the earlier years of [illegible] [illegible] take [illegible]

MR. BOYLES: No, I have not heard that but I have heard auditors say that we should take advantage of favourable profit conditions to provide for the contingent losses in respect of our risk assets.

COMMISSIONER MACKINTOSH: Could we take this non-action on the part of the shareholders' auditors as their judgment that the reserve is not more than adequate, for if they are they do create a future tax liability?

MR. NEAPOLE: Yes.

THE CHAIRMAN: The next point in connection with this problem is the justification of the hidden nature of these reserves. I understand there are reasons for this, that it has been considered sufficient in the past. Whether or not the same conditions are equally applicable today is a question we shall have to consider. Would you care to comment on the justification for the secrecy of the amounts of these reserves?

MR. BOYLES: Mr. Chairman, there was some reference, of course, to this point in the brief. In our opinion we feel that there would be a lot of disadvantages in disclosing these figures. We do not believe it is in the best interests of the public. I think that it is better rather than to display or to divulge or disclose the figures that we should be careful not to indicate, let us say, any prospective weaknesses that might be assumed from the respective figures.

In other words, the disclosure could conceivably lead to some fear on the part of the depositor. This is a subject which, of course, has been considered in other areas, and the general concensus has been that it is not in the best interests to disclose such figures. I mean, I merely add this as a bit of support to our thinking.

THE CHAIRMAN: Well, these questions are constantly being raised, and we want to get all the information we can about them. Is there real ground for thinking that the depositors would lose confidence in a bank simply because certain losses were shown in a certain area?

MR. BOYLES: There might be. Probably one of the things that might prompt some wonder, if not fear, is the fact that you might be making large provisions in good years. In other words, there does not seem to be any constant provision. As I mentioned earlier, it is the policy, if possible, to make provisions in the good years thereby to provide for these provisions in the poor years.

THE CHAIRMAN: If there was sufficient provision made, would there be any objectinn then in publishing everything? Then the depositor would look at the statement and he would see this very large provision and he would be satisfied that it would take care of any possible losses, that if a loss occurred he would not feel badly about it, actually.

He would also know that the bank had

adequate capital. As a depositor would he necessarily be disturbed about that?

MR. BOYLES: We think that these shifts, and having regard for size and experience, could be disconcerting to the depositor.

COMMISSIONER MACKINTOSH: May I ask a question, Mr. Chairman? Is this subject of non-disclosure indivisible? I seem to recall that some banks have in their own accounts disclosed withdrawals from inner reserves at times. When there is a withdrawal is that information required to be disclosed or is it on an optional basis?

MR. BOYLES: I think it is an automatic disclosure.

MR. NEAPOLE: Yes, it is an automatic disclosure. It shows up in our statements of undivided profits.

COMMISSIONER MACKINTOSH: The amounts that are placed in the inner reserves are not disclosed?

MR. BOYLES: That is right, sir.

COMMISSIONER MACKINTOSH: And the total amount is not disclosed?

MR. BOYLES: Right.

COMMISSIONER MACKINTOSH: Is there the same objection to disclosing the amounts which have been carried to the inner reserve in the year as there is in disclosing the total amount of the inner reserves? If you disclose the amount carried, the person looking at the bank income who wants dis-

closure, in the sense that the security analyst asks for it, has gone a considerable distance towards his goal. Is that just as objectionable as the total amount?

MR. BOYLES: Probably one point in favour of not making such disclosure is the variations of requirements or practices amongst banks in respect of that subject.

COMMISSIONER MACKINTOSH: I would think generally the basis of your addition to inner reserves, aside from the leeway that the formula gives you, is that you have had a good year. Is there too much reason for keeping that a secret from the poor shareholder? I can see that a big withdrawal from inner reserves might make you nervous, that it might give rise to the presumption that you had heavy losses. But you tell me that you have to disclose that anyway.

MR. BOYLES: Yes, we do that.

MR. WADSWORTH: No.

MR. BOYLES: No, I am sorry. It is the other way. It is not as they relate to losses. We do not have to make any disclosure there, but if we want to transfer an amount out it has to be published. This would be automatic.

COMMISSIONER MACKINTOSH: Well, there is no doubt that some of your less sophisticated shareholders would interpret that as something you had to do on account of a bad year. I was just wondering if everything had to be secret or whether

this problem could be broken down. We get from people like security analysts the argument that the shareholders are left completely in the dark. The published accounts show what the income is after certain undisclosed transactions, not necessary but convenient transactions, have been carried out in respect to them.

MR. MULHOLLAND: In this particular regard, Dr. Mackintosh, and I am speaking only on my own account, I think this matter of disclosure should be taken by bankers as of least concern to shareholders but of major concern to depositors in so far as disclosure is concerned. I believe this has been debated in England. As long ago as the Cohen Committee it was said that the interest of the depositors outweighed the interest of the shareholders in respect to disclosure.

There are many things involved but the stability of the banks must never be in doubt. I am not quoting from that committee in using those words, but again quoting from that record it is not in the public interests to endanger the stability of the banks or to undermine the confidence of the public in the banks.

COMMISSIONER BROWN: Could I draw to your attention, Mr. Mulholland, that there has been a more recent committee in action on this point, the Jenkin's Committee, which brought out its report last summer. This committee recommended by, I think it was nine to four or five against, that

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

secrecy be maintained as to the reserves of the British banks. I think you should also bear in mind there is this distinction that these are after-tax reserves.

THE CHAIRMAN: Yes, but that distinction --

COMMISSIONER BROWN: May I carry on for a moment?

THE CHAIRMAN: Yes, go ahead.

COMMISSIONER BROWN: In the United States the opposite seems to prevail and that is that in New York State, as I understand it, their tax-free reserves are disclosed. So, you have in one case the reserves that are secret, and in New York State you have tax-free reserves but they are disclosed. For the rest of United States I understand the Federal Reserve System is encouraging disclosure in those states that do not now require it. The Saxon Committee, which recently reported down there, has recommended disclosure.

Canada is frequently more or less half way between the practice in the United Kingdom and the practice in the United States, and in this particular instance it seems that the banks have got the best of all possible worlds. Perhaps this is the Valhalla that we heard about before.

THE CHAIRMAN: It is a great thing to live in Canada. Take the position of the depositor. It is true that the depositor is of the first concern. He takes precedence over the shareholder, but if the depositor is willing to deposit

his money in a bank and if he is a very prudent and wise depositor and looks at the balance sheets of a particular bank and studies everything he can find about its activities and he finds that on the face of that balance sheet he is satisfied it is a sound institution and he knows that in addition to the figures disclosed in the statement there are certain hidden reserves, although he does not know how much they are, but he does know there are some hidden reserves, and if he decides to deposit money in that bank, then how can he lose anything if it turns out that the hidden reserves pop up some time and bail out a situation with which the bank is faced? I do not see how he is harmed by the secrecy.

MR. BOYLES: It is the other way around, sir. We feel that he is probably protected by the secrecy.

THE CHAIRMAN: I was just moving part way in the chess game. I was not prepared to go too far. I was just looking at it in a certain way. I would think that there would be some difficulty, though, from the point of view of the shareholder because the directors of the bank would have full knowledge of these matters and the ordinary shareholder would not.

MR. MULHOLLAND: That situation pertains, Mr. Chairman, in any company.

THE CHAIRMAN: I suppose it does, but other companies do not have this sort of reserve.

COMMISSIONER BROWN: Mr. Chairman, I do not like to appear to be harping on a particular subject here, but I should like to return to this knotty problem we were discussing prior to getting into this one. I refer to the question of authorized amounts of credits for borrowers who are represented on boards of banks by mutual directors. We were given the answer that this report was in Schedule "M". I must apologize, for I read it quickly, but as I read it now it does not give the answer, for it says, "Credit amounts of loans to directors and firms of which they are members and amounts for which they are guarantors."

This does not, in my interpretation of the phraseology, cover corporations. It only covers personal loans and loans to un-incorporated firms. The question referred to loans and the various lines of credits to directors and corporations of which they are directors. I am not blaming anybody. I think we got lost in the terminology.

MR. WADSWORTH: I am sorry that I misunderstood what you were referring to.

COMMISSIONER BROWN: But is it clear now what we are looking for? Perhaps we could get together at the recess if there is any further confusion with respect to this.

COMMISSIONER GIBSON: Mr. Chairman, I have a couple of general questions on the matter of monetary policy and how it fits in generally with other kinds of economic policies. There is

not any reference in the first chapter, the introductory chapter on policy objectives and instruments in relation to debt management and how it fits into monetary policy,except at the end of the chapter it says that it is another policy instrument.

I wonder if any of the bankers would say a bit about how they see debt management and monetary policy working together? Should they be more closely meshed together? Should debt management be used with monetary policy as an aid to achieving monetary objectives and changes in credit conditions and, specifically, interest rates?

DR. McLEOD: Reference to debt management at that point was, as you say, in a secondary position, for it is envisaged that the primary instruments of economic stabilization are conceived by most people to be monetary policy and fiscal policy. There is a short definition of each of those given in the brief.

The reference that you have to the paragraph where we do mention the other policy instruments is primarily to emphasize that indeed these two major instruments must be supplemented by others in order to have their full effect. I think the major distinction between them is that monetary policy and fiscal policy are intended to operate fairly directly on the spending stream. I could say with perhaps specific reference to debt management, if I am right that that is the one to which you wanted particular attention paid, that per-

haps there is not as yet the same body of opinion about just what debt management is and what it can do as there is in the case of monetary policy and fiscal policy.

A good deal has been written on this at various times from various points of view, but I think it would be fair to say that it has not been shaken down, if I may use that phrase, to establish a really agreed basic level of what is meant by debt management, how it operates, and what can be expected of it. If I remember correctly, I think there is a reference in the brief to fiscal policy having been developed, or originally conceived as a supplement to monetary policy, and many of the ideas we include under this rather vague heading of "Debt Management", again, could be said to be supplementary to monetary and fiscal policies. Surely, at a minimum level people would agree that debt management does have a function in terms of ensuring that issues that are sold in the process of financing activities of the government, are presented on a basis that is compatible with the market, on a basis that helps to sustain the confidence of the market and the soundness of official policies, and helps to create conditions, liquidity conditions particularly, appropriate to the situation.

When you try to extend beyond that the area of agreement becomes less, and I do not mean to say that many of these things are wrong, particularly, but I do not think that the rights and the wrongs and the nuances of right and wrong have been worked out to a satisfactory extent.

One sometimes gets the impression from some of the more extreme statements that the government should not borrow long at all, and in

one phase of the cycle should not borrow long because that is starving the private sector at the one phase, and in another phase the government should not borrow long because that is acting on interest rates unnecessarily. It seems you should only borrow long when the market is turning, which is surely the wrong time to do it. I may be making a characature of this, and I am sorry, because I do not mean to.

COMMISSIONER GIBSON: What I want to know is this, in paragraph 462 we have an implication -- it is not an implication, but a statement that monetary policy should not be used for short-term ends, to aid in the distribution of new issues. The sentence is:

> "In effect, both these techniques mean using monetary policy, which is designed to work over a period of months, for short-term ends,..."

Can you really make such a distinction? I would like to see you develop this particular point. Some people think that debt management and monetary policy should work closely together, but this suggests the necessity for differentiation between the two.

DR. McLEOD: I think that should be answered by our people dealing specifically with debt management day-by-day. However, before stopping, I would like to make a suggestion, that the idea of co-ordination of policies does not mean

they all have to be pulling exactly in the same direction. If I may use a rather homely analogy, I think we are all familiar with the ropes on a tent that have certain tensions in various directions but it is a question of adjusting the tension that gives a co-ordinated and stable position. I think the debt management people should handle that question.

MR. WADSWORTH: I just wonder again, Mr. Gibson -- and I may not be in a position to answer this -- your question is as to debt management in the total picture, relating it to paragraph 462. You are referring to paragraph 462 in our brief?

COMMISSIONER GIBSON: In the opening section of the brief you do not put much emphasis on debt management, but it is merely mentioned as another area of policy.

MR. WADSWORTH: Yes.

COMMISSIONER GIBSON: In paragraph 462 you seem to me to make it fairly clear that you feel that debt management and monetary policy ought to be pretty clearly separated. You say:

> "In effect, both these techniques mean using monetary policy, which is designed to work over a period of months, for short-term ends, ..."

This is an interesting area, and it does not fit in with some of the other ideas we have had presented to us.

MR. AVISON: Perhaps if I might speak to this point, I think Mr. Brown raised the same

point yesterday morning. I believe we were thinking in the preparation of that section of the brief of the operation of the security market itself rather than the more general economic problem of the relationship of debt management to monetary policy. I think that underlying our ideas in that sense were the various elements that create uncertainty in the marketplace, interferences of one kind and another.

There is a rather peculiar pattern that seems to take place around the time of new issues, which creates uncertainties in the interpretation of current monetary policy and your reaction to the new issues. I believe the underlying philosophy we have here is that any distortion -- looking at it from the market end of the spectrum rather than the economic end of it -- that gets into the marketplace tends to distort the marketplace and over a time may be worked out in the marketplace and may, in turn, create more sort of protracted dislocations than might otherwise be the case. I think it is in that context that this turned up in that section of the brief.

COMMISSIONER GIBSON: There is one other area I would like to explore with you. It has to do with how monetary policy works through the banking and interest rate system, and what its limitations are. You say quite a bit about its limitations, again in that opening section, particularly in times when the economy needs stimulation. You point

out it may not have very much effect in stimulating the economy when business expectations are not good. You point out you cannot expect monetary policy to act as a major stimulus in getting people into new areas. You say it is a blunt and imprecise implement. In other words, you do stress its limitations as a stimulus, and you do not say very much about its effectiveness as a restraining influence at times.

What I would like to know a little more about is, in using your experience how do you see monetary policy working? It works through interest rates, through greater difficulty in obtaining credit. Do you see higher interest rates -- and I am thinking of the restraining side -- causing much postponement? Do you see business decisions being changed as a result of the difficulty of getting it? Do you see inventories being cut, and that sort of thing?

Another aspect of this is, what is affected first in a restraining policy? Is it the speculative things that are cut back first? Is it the municipalities? Is it term things, and so on? Could you elaborate a little more on the way this works out?

DR. McLEOD: I think I can at least answer the first part of that group of questions, or get the answer going. I gather that perhaps you want to get the feeling of people who see this through the eyes of the operations of their

customers. What you have said at the start does reflect our thinking.

The common simile is that monetary policy is like a rope: it is very easy to hold things in with it; but you cannot push them out. I have sometimes used the analogy of the string of a kite. You have a kite flying fine in a strong wind, and cut the string and the kite does not go up but falls down, and the string on the tension does have some function in holding the kite in a reasonable position in relation to the wind. But if the wind falls, the kite falls too.

In terms of how it operates, at this theoretical level it seems to be primarily in terms of assuring a favourable climate of operations. So if there are activities that look to the business-man to be profitable coming forward, there will be a demand for money and you make sure it is available to him and at a rate of interest that is not going to shock him. I suppose we are thinking now, essentially, not of depressed times but at least relatively slack times.

Mr. President, that is as far as I can carry this, and perhaps the people who deal with the customer across the desk might have something to say as to how they feel this affects the customer. I take it for granted you are satisfied we know how monetary policy operates between the Bank of Canada and the banks. We have had some discussion in this field, and I suppose you are getting

at: That is fine up to there, but what happens outside the bank's door? Is that it?

COMMISSIONER GIBSON: That is right.

MR. WADSWORTH: I would add a comment to keep it moving along. I would think the first effect, from a practical point of view, would be on the speculative type of operation that was requiring bank funds. This is as it relates through the bank. I do not think there is any question of that. As it began to take effect that would be the first area to be affected. I think as you go down further it may be a little harder to establish in just what order various effects come into the picture.

I think one of the next or near the next one would be expansion in various lines of business of probably not as speculative a nature and not as essential a nature, but still of a somewhat essential nature which would require the use of men and materials in a period when men and materials were short, if that was one of the reasons behind the change in monetary policy. I think it would work down from that.

COMMISSIONER GIBSON: You are thinking of the effect of bank lending policies on customers of banks. Would you care to say anything about the effect of higher interest rates that result from a tighter monetary policy in the capital market? Let me put it more specifically. When the central bank holds cash steady in a period of

expansion two things, or a variant of two things, can happen to the banking system. Either they can sell securities and other liquid assets for quite a while and not greatly change their policy; or they can fairly soon start to tighten up their monetary policy -- and this would depend on the degree of liquidity.

What I want your opinion on is: Which has the most effect in restraining business decisions; or is there any difference? The effect of selling securities is initially rather rapidly to raise interest rates and this is transmitted through the capital market. The effect of restraining monetary policy has an effect on the short term in particular, and some in the longer term too, and a much more gradual effect on interest rates. Can you conceive any great difference in effect the same amount of restraint has on the community, depending on whether it comes out in a substantial sale of securities and a further increase in loans or a checking of loans right away? This is a very important point, and an opinion on it would be very helpful.

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MR. HACKETT: I think we are into this matter of public expectation.

COMMISSIONER GIBSON: Right.

MR. HACKETT: And public response. There is a multiplicity of consequences that come into the picture.

COMMISSIONER GIBSON: It is a rather complicated question and I do not pretend to know the answer.

MR. HACKETT: One thing that was running through my mind while this discussion was going on was that on occasion there can be a curious sort of perverse reaction to monetary policy which arises out of public expectations. If, for example, an important sector of the borrowing public believes a cycle has started which means money is going to be tighter, that triggers a demand for loans that is somewhat apart from the actual necessities of the moment, and it gets to be almost an endeavour to pot up credit. That is one aspect of the matter there. I suppose that is, perhaps, part of the broader principle that would suggest itself here, that as the public gets more sophisticated and as every man becomes his own economist, almost, the reaction in these things tends to speed up. I think that probably has been the case in comparing, say, the reactions of 1959 to 1955.

Just one more thought -- and I do not think this is in any way a conclusive answer to the questions you have raised: I think that in the final analysis the greater bite, as it were, proceeds from the availability of money rather than the price of money.

COMMISSIONER GIBSON: Bank credit or money in general?

MR. HACKETT: Money in general, including bank credit. After all, in the case of a corporation half the added costs of the higher interest rate is largely absorbed in the tax rate. The fact the banks are selling securities creates problems for the banks, but the problems for the borrower, as long as he gets his money, are indirect. His money may cost him more, but he still gets it. But when the process proceeds to a point where money is harder to get, no matter what the price, I think the bite then is considerably more severe and more effective.

COMMISSIONER GIBSON: Do you think availability is rather more important than cost?

MR. HACKETT: Yes, I do.

COMMISSIONER GIBSON: Though cost and availability are pretty hard to separate, because as interest rates go up people are less inclined to pay higher rates and the whole structure tends to go up and not just the high quality rates.

MR. HACKETT: I do not think we can compartmentalize these things. But, surely, despite costs the availability of money is still rising. The banks may be selling securities in order to make loans, and by hypothesis loans are still rising and, therefore, an additional demand is being met, but when that process ceases loans cease to expand and, surely, at that point the bite in terms of effect on the would-be borrower becomes a little more effective.

COMMISSIONER GIBSON: In this process of selling securities, somebody else has to buy those securities and find the funds.

MR. HACKETT: That is true.

COMMISSIONER GIBSON: This puts pressure on the market, it affects the interest rate structure, the general level of the rate that other people have to charge for interest, and so on. It is a very complicated and long process. However, you suggest that the bank's lending availability is more important than the interest rate effect.

MR. HACKETT: In answer to your question, sir, I am trying to put myself inside the skin of a borrower. I would think from a practical point of view that the really important thing is, do I get my money or don't I? The cost of that money may be secondary, particularly if I am a tax-paying corporation.

COMMISSIONER GIBSON: But I don't think it is quite as simple as that. If the bank doesn't give the man the money, he tries to get it somewhere else. He would find it easier to get the funds if the bank had been selling securities. The two things affect the same channels.

MR. HACKETT: That is an added complication, and it is not a simple equation such as A plus B or A minus B.

MR. WADSWORTH: There is a further complication -and in this I am speaking about borrowing, the reason for the borrowing, what the borrower expects to earn from it, and the term for which he is borrowing. There

are certain areas where probably a higher rate for a short-term would not have the same affect as a high rate for a long-term.

COMMISSIONER GIBSON: And, of course, the long term interest rate structure is particularly affected if the banks securities sales are heavy.

MR. WADSWORTH: Yes.

COMMISSIONER GIBSON: I am only suggesting that they apply to another segment of the whole.

MR. WADSWORTH Yes.

COMMISSIONER MACKINTOSH: It seems to me that in this argument about availability and interest rate, there are usually a number of implicit assumptions. When you say the money is not available, that is not an inference; that is conclusive.

MR. HACKETT: That was the point I was trying to make.

COMMISSIONER MACKINTOSH: If the interest rate goes up - if you could pay a half per cent more and get away with it, why not pay three-quarters per cent or more? That is not conclusive in the same sense. I question whether the availability of money can be defined as precisely as is implied in most of these statements. If it is not available in one place or in one piece, under certain conditions it is available elsewhere, and pieces can be put together. I don't think availability is quite as elastic as it would appear in these arguments. Probably the reason it is available is because somebody else won't pay the high interest rate, and therefore leaves it for someone

else who is looking for credit.

MR. HACKETT: I would agree, Dr. Mackintosh, that money tends to come out of odd corners at times of monetary stringencies. If I might suggest an analogy with which you are very familiar: those of us who had anything to do with rationing of commodities during the war, evolved a sort of principle that when any commodity is rationed you can be sure that the total available supply will be used.

COMMISSIONER MACKINTOSH: And if you start in industry you soon discover the most amazing bits of information as to where a commodity is used.

MR. HACKETT: Precisely.

THE CHAIRMAN: Gentlemen, that concludes the discussion.

MR. WADSWORTH: Mr. Chairman, there was one other point that we thought might come up in the discussion this afternoon, and which we might put on record now.

We hope there is no misunderstanding on this question of earnings from a banking operations point of view, on investments, or loans. There is no question in our minds, bearing in mind the type of operation we are in - and I am not trying to make a speech as to our responsibilities, though we believe we can produce figures to substantiate this - our rate of earnings, our yield on loans, is more important to the bank than our earnings or rate of return on investments, having in mind that investments must play a complementary part to the other operation.

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MR. MULHOLLAND: Mr. Chairman, may I at this point, and with your permission, express to you and the other members of the Commission the appreciation of this group for the patient and understanding attitude you have shown to the answers we have endeavoured to give you. This has been a team effort, and I hope that you will find that the contributions made by the group will be useful to you in your future deliberations.

THE CHAIRMAN: I can assure you, Mr. Mulholland, that the contribution made by the Canadian Bankers Association is invaluable to us. We have learned a great deal - that is, those of us who are not bankers. We are very much impressed with your written submission and also your contributions during the discussion.

As you know we are faced with many problems and conflicts of interests, and some rather knotty problems. I believe I can speak for all members of the Commission in saying that when we face the prospect of coming to some decisions our work will be much easier as a result of the help and assistance you have given over the past three days.

MR. MULHOLLAND: Thank you very much.

THE CHAIRMAN: We will adjourn now until tomorrow morning at 9:15 when we will hear submissions from Mr. McLaughlin, Mr. Hart, and Mr. McKinnon.

--- Adjournment.

[illegible]

Mr. McFarland: Mr. Chairman, may I at this point, and with your permission, express to you and the other members of the Commission the appreciation [illegible] of this group for the patient and understanding attitude you have shown to the comments we have endeavoured to give you. This has been a team effort, and I hope that you will find that the contributions made by the group will be useful to you in your future deliberations.

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Mr. McFarland: Thank you very much.

THE CHAIRMAN: We will adjourn now until tomorrow morning at 9:15 when we will hear submissions from Mr. [illegible], Mr. [illegible] and Mr. [illegible].

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Royal Commission on Banking and Finance

THE CANADIAN BANKERS ASSOCIATION

SUMMARY

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BRIEF

Hearings held at

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SUMMARY AND RECOMMENDATIONS

INTRODUCTION

1. The chartered banks of Canada wish to commend the members of the Royal Commission for undertaking the onerous duties of this most important enquiry and to express the hope that their efforts will result in measures of lasting benefit to Canada as a whole. For their part the banks have given their full co-operation in furthering the study in which you are engaged, and hope in presenting the brief which follows that the facts and opinions set out will be of material assistance in your deliberations. The brief does not pretend to offer definitive answers to all the questions it raises, because these matters carry well into areas where value judgments must be made between alternative objectives and where it would be neither possible nor desirable for the chartered banks as a whole to speak with one voice. However, any specific proposal that is advanced in this brief has the support of the banks generally.

2. The brief begins with an outline of the chartered banks' views about the general framework of monetary and fiscal policies, and about the overall financial framework within which the banks must operate. Next comes a description of the principal operations of the chartered banks, which covers bank cash reserves, investments, loans deposits, earnings, capitalization, and related topics. After that there is a discussion of broader financial topics, including competition among banks, competition with other institutions, interest rate policies, and certain central-bank control techniques.

The recommendations the chartered banks wish to make are included in the course of the presentation as they arise naturally out of the discussion.

THE ROLE OF FINANCIAL ORGANIZATIONS

Policy Objectives

3. The most generally accepted economic objectives are full employment, stable domestic prices, healthy economic growth, and a sound and dependable relationship between the domestic economy and the world economy of which it is a part. In pursuance of these objectives it may be taken as a general principle that the methods used should be those of the normal price and market mechanism as far as possible, or at least should be compatible with the effective operation of that mechanism.

4. However, it is also generally recognized that the attainment of these various objectives may at times interfere with one another. Where a choice has to be made between conflicting or partly conflicting objectives it is proper in these situations for the choice to be made by the Government, as the responsible elected representatives of the Canadian people.

5. Monetary policy and fiscal policy are generally thought of as the two main instruments available to the authorities for pursuing the major economic objectives described above. When properly used they are compatible with the price and market mechanism; indeed, smoothly operating financial markets are important to the optimum effectiveness of both monetary policy and fis

policy.

Other Policy Instruments

6. It is quite possible that there is too much concentration on monetary and fiscal policies, as if they were the only means of promoting the desirable economic objectives discussed earlier. In point of fact, there is a wide range of additional measures that can be employed to good effect, for example, public debt management, taxation policy, commercial, tariff, and exchange rate policies, and measures to encourage increased productivity. However, this brief must be concerned primarily with monetary matters.

The Role of Finance

7. One of the major functions of the financial system is to mediate between those who do not wish or are not able to invest their savings directly in physical assets and those who draw on the savings of others to supplement their own resources. A substantial portion of this mediation takes place through the arrangement of loans or the purchase and sale of securities between principals, either in direct negotiation or in transactions through investment dealers and brokers on organized or over-the-counter markets; it may involve the issue of new securities or loan contracts or other types of financial claims, or trade in existing claims. Another major portion takes place through various financial institutions, such as banks, trust companies, mortgage loan companies, credit unions, insurance companies, finance companies, small loan companies

factoring companies, and others, which receive funds from one group and lend to another and accordingly may be described as financial intermediaries.

8. The importance of effective financial organization is implicit in the need to maintain a balance between the community's investment demands and the flow of savings it tends to generate when all its resources are fully employed. Any tendency to imbalance in this relationship will make itself felt in financial terms, and so must any measures taken to correct such a tendency. Both monetary and fiscal policies operate by influencing one side or the other of this relationship as reflected in the supply of and the demand for financial claims. Sound and responsive financial institutions and financial markets are thus essential to the use of these policies for promoting Canada's major economic objectives.

9. Until fairly recent years it was generally held that banks were categorically different from other financial institutions in that the former could "create" credit whereas the latter could only re-lend funds entrusted to them. Even today there are those who maintain this position. However, an increasingly influential body of opinion now holds that credit "creation" is not peculiar to the banking system, but occurs in basically the same form in various parts of the financial structure. The emphasis is placed on the general liquidity of the economy, not on the quantity of money alone. It is argued that the total resources available to the capital market and to all financial institutions combined

is determined by the laying aside of financial savings out of income, and that the allocation of these resources to banks and to other financial institutions is determined by the free choice of savers in deciding how to employ their savings. The distinction between banks and other financial institutions lies not in any mysteriously different source of resources but in the ready acceptability of bank deposits by spenders and savers alike; bank deposits are a particularly attractive form of liquid asset because they are a means of paument and hence are useful not only as a savings vehicle (liquidity motive) but also as working balances (transactions motive).

10. It is of course technically true that the Canadian banking system can expand its assets (in the form of loans or investments) and its liabilities (in the form of deposits) within limits fixed by the amount of cash reserves the Bank of Canada allows them. However, the banks themselves cannot determine these limits. It is entirely within the power of the national monetary authorities to decide what level of bank deposits is appropriate.

11. The object of the authorities in using monetary and fiscal policies must be to maintain a balance between the economy's investment demands and its rate of saving at optimum levels of income, taking account of the limitations of these policies themselves. This means maintaining the smooth flow of the spending stream as a whole. From this point of view it makes no difference whether a loan-financed expenditure is made possible by

the expansion of the money supply (quantity of money) or by more intensive use of the existing money supply (velocity of circulation), for both affect the spending stream. It is clear therefore that the authorities should be concerned with all forms of credit, including that granted by other financial intermediaries as well as by banks and including that obtained through the money and capital markets.

12. The type of lending business carried on by the various financial intermediaries should not be determined by arbitrary rules, but should be left to the play of market forces and natural specialization. Institutions with long-term contracts predominating among their liabilities, such as life insurance companies and pension funds, may be expected to seek relatively long-term outlets for their funds, including bonds and mortgages, though of course they will need some shorter-term and therefore more liquid assets as well in order to allow for unexpected variations in their cash flows. Institutions that are designed to provide specialized forms of credit, on the other hand, such as finance and factoring companies, etc., may try to raise funds through contracts with maturities more or less comparable to their loan contracts. In general, however, there is no compelling reason for having precisely matching maturities in the borrowing and lending contracts of the same institution, provided a liquid reserve is maintained that is adequate to the risks involved and provided also that the asset "mix" is appropriate to the fundamental nature of the business.

13. In the case of banks it was formerly thought necessary that they should confine their loans and investments to short-dated maturities, because their obligations are repayable on demand. Nowadays, however, it is recognized that it is feasible for them to put a limited portion of their funds into longer-dated loans and investments. Nevertheless it remains true that the first priority in bank lending must still be given to short-term business borrowing for working capital purposes, because the banking system in Canada, as in most other parts of the world, developed in response to these needs and there appears to br no other source similarly qualified to provide, administer and supervise this type of loan.

The Role of the Banking System

14. Banks are clearly financial intermediaries, and clearly have a special role to play in the functioning of the financial system. However, while "a bank" in popular understanding is a specific and readily identifiable type of institution, it is not easy to find a satisfactory definition -- a problem that is by no means peculiar to Canada. The Bank Act gets around the difficulty by defining a bank as "a bank to which this Act applies" (s. 2), i.e. "each bank enumerated in Schedule A" (s. 4), but that leaves the real question unanswered.

15. It seems impossible to define banking in a way that meets universal acceptance. In what follows, unless otherwise indicated by the context, the word "bank" will be synonymous with "chartered bank" and will be used

in the sense in which it is defined in the Bank Act.

16. Just as one of the recognized key functions of a central bank is that of lender of last resort for the commercial banking system, so the commercial banks in turn perform a similar function for other financial intermediaries, though this is probably less well understood. These institutions typically carry working balances with the banks, just as other businesses do. They also customarily maintain lines of credit with their banks, whereby they are able to borrow on short notice within agreed limits. In this way they are able to operate with minimum working balances and yet with reasonable assurance of being able to meet any unexpected demand for funds. The liquidity of the entire financial structure thus depends largely on the liquidity of the banks.

17. Modern views of the respective rules of banks and other institutions within the financial structure differ substantially from those of even a generation ago, and indeed one of the most important tasks before the Royal Commission may be that of putting these relationships in better perspective. Without treapassing on the ultimate findings of the Commission in this respect, however, it may be said that the present-day questioning of older ideas in this field does not detract from the key role of the banking system in maintaining a balance between the saving and investment decisions of the community. When business is slack the almost universal acceptability of bank deposits by spenders and savers alike assures the community

whatever degree of liquidity may be necessary to sustain business operations. In times of inflationary boom the dependence of a community on money as the means of effecting transactions offers the authorities a powerful and flexible weapon for keeping the volume of spending in line with the physical volume of goods and services becoming available.

18. For their part Canadian banks from earliest days have recognized the need to co-operate with official financial policies in the public interest. They recognize this need no less now, because of the key position of the banking system in carrying out such policies in promoting economic stability.

19. It is therefore submitted that the public interest is served by the existence of a strong banking system. A bank is more than a repository of deposits on the one hand, and a medium for making loans and investments on the other. The fact that the deposits entrusted to the chartered banks are the banks' liabilities to the public is an accounting truism, but its real significance tends to be overlooked or taken for granted. Not since 1923 has ghere been a bank failure in Canada. Thus, for a generation, no Canadian has lost a night's sleei worrying about the safety of his "money in the bank". Indeed, the Canadian banking system enjoys a world-wide reputation for soundness and stability, and this in itself has been a factor of no small significance in the nation'a economic development.

THE OPERATIONS OF THE CHARTERED BANKS

Reserves

20. The pivot around which monetary control of the banking system revolves is the cash position of the chartered banks. The requirements of each bank in respect of the management of its own cash position provide the basis for central-bank regulation of the banking system as a whole. For any one bank, managing the cash position is a matter of keeping the cash on hand adjusted to the needs and wants of the bank for cash to hold. When the cash on hand exceeds what is required, taking into account everything that influences a bank to hold cash, the bank sets out to exchange the excess cash for earning assets, thus expending its holdings of earning assets and also possibly its deposits. Similarly, when a bank concludes that it has too little cash relative to its requirements it sets out to acquire cash by disposing of earning assets, thus tending to contract its holdings of earning assets and also its deposits. Thus, whether at any moment of time the banking system will be tending to expand or contract its earning assets and its deposits, depends on the combined cash position of all the banks. For example, if the combined cash on hand exceeds the combined requirements of all the banks, the system will be trying to expand. Hence monetary control, in the sense of inducing the banking system to expand or contract, is a matter of the central bank altering the supply of cash to the banks relative to their requirements for cash.

21. The present method of fixing the reserve requirements in advance for the next reserve period has been criticized on a number of grounds. It has been pointed out that changes in the reserve base, and so in requirements, may at times be quite abrupt, requiring similarly abrupt intervention by the central bank if it wishes to maintain the same degree of ease or tightness of reserves. It is also contended that the present method does not cause requirements to change fast enough when all banks are expanding simultaneously. In any one month the banks could expand in step and would face no restraint from a rise in requirements until the following month. It is asserted that tying bank reserve requirements to the latest deposit figures would make monetary policy more effective because any increase in deposits would bring an immediate deficiency in the cash position, and the banks would react as if the central bank had taken cash away from them.

22. As the requirements stand at present, however, the central bank can readily counter any unwanted expansion or contraction almost immediately by open-market sales or purchases of securities. If for example there is an expansion because the banks are adding to their holdings of marketable securities the central bank could offset it by selling securities. If on the other hand the banks are adding to their loans the effects will now show up in the open market, at least not immediately, but in the deposit liabilities of the banking system. If the central bank sees deposits rising when it would prefer them not to rise, it can withdraw cash from

banking system to counter the expansion.

23. Whether an automatic change in the cash position, caused by a rise in requirements, is to be preferred over a discretionary cash change, produced by the central bank selling securities when it sees bank deposits rising, depends primarily on whether the automatic cash change would occur faster than the discretionary change. If the central bank did not receive deposit figures until much later than do the individual chartered banks, there would clearly be merit in favouring automatic cash changes. Under Canadian conditions however deposit figures are available to the central bank almost as soon as they are to the individual chartered banks.

24. Another criticism of the present formula for setting reserve requirements is the length of the averaging period, i.e. a calender month, which is alleged to cause the banks to be sluggish in response to their daily cash position. Rapidity of response, however, also depends on the instruments available for adjusting bank cash and on the volume of transactions that the market in those instruments can handle. The shorter the reserve period the better the market has to be and the greater the variety of instruments required. A shorter period would make it more difficult for a bank to carry out its cash adjustment transactions in the money market. On the selling side it would have to bunch its transactions more, and on the buying side it might have to forego some transactions because of limitations. In other words, shortening the reserve period

does not necessarily lead to faster responses.

25. If the averaging period were shortened, however, the present restrictions on chartered bank borrowing from the Bank of Canada should be eased, and indeed these restrictions merit review in any case. It is now the practice for the Bank of Canada to make advances against the hypothecation of suitable securities, and advances to each bank are normally limited to a specified amount somewhat resembling an established line of credit; these limits have not been changed in many years notwithstanding the substantial increase in banks' assets and liabilities. Each advance or renewal of an advance is made for a fixed period of seven days. The first advance in any calendar month up to the specified amount bears interest at the Bank Rate. However, a second advance to the same bank in any calendar month, or a renewal of an advance, or an advance in excess of the specified amount, bears interest at some unspecified higher rate and is subject to negotiation. These limitations interfere with the traditional role of the central bank as lender of last resort. Moreover, a "Bank of Canada Funds" market would probably be a prerequisite for overcoming the difficulties that would ensue. A "Bank of Canada Funds" market, in which banks could sell their excess cash with the Bank of Canada to banks in need of cash, could be introduced, as in the New York money market where there is active trading in "Federal Funds". Whether such a market should be introduced even under the present method of calculating reserve requirements depends on the ultimate effect it would have on the

money market. We are not opposed to such an innovation, but we believe that it would inhibit the development of the money market.

26. On balance we consider the advantages of fixing the cash reserve requirements in advance and averaging reserves over a calendar month outweigh the disadvantages. We recognize that in the public interest bank credit policies must conform to the requirements of monetary policy with reasonable promptness, but we feel that any proposed change should be clearly justified in advance, especially if it would add to the burdens that are imposed on the chartered banks and only on the chartered banks.

27. If reserve requirements are imposed on banks only, however, it is important for monetary control that they be not set too high. Reserve requirements imposed solely on the banks place the vanks at a cost disadvantage relative to non-bank competitors, which of course encourages the growth of these competitors relative to the banks. As a result, the central bank has to restrict the size of the banking system to compensate for this additional growth in non-banks, and the effect is that the control base on which the central bank must act becomes smaller relative to the total financial system with the passage of time. In other words, reserve requirements applied to banks alone should be no higher than necessary so that the efficiency of monetary policy will be preserved.

Investments

28. One of the primary functions of a chartered bank is to make loans. It follows that bank investment activities are normally subsidiary to bank lending activities. Since loans vary as a result of seasonal, cyclical, and irregular influences, a chartered bank must be able to adjust other earning assets up and down fairly readily in order to accommodate its borrowing customers; the investment portfolio permits this to be done while employing the residual funds profitably. On the deposit side, although the total deposits of an individual bank tend to remain relatively stable in relation to the banking system, the cash position can be sharply affected over short periods of time through temporary gains or losses in the net clearing of funds among the banks. In order to meet any conceivable cash withdrawal, large or small, on demand and without the slightest qualifications as to its immediate availability, a bank must have readily realizable investment assets in addition to cash itself.

29. Another reason for an investment portfolio is to give a balanced structure to the bank's assets, which is important for a flexible bank lending policy and for maintaining the confidence of the general public and of customers at home and abroad. The weight of risk assets must be balanced by a proportion of relatively riskless assets, such as securities of the Government of Canada.

30. In the maintenance of their investment portfolios the banks do from time to time participate in the financing of federal, provincial, and municipal governments,

and to a lesser extent of corporations. As national savings institutions, the banks share in the task of providing funds for the financing of both current and short-term capital requirements of all three levels of government. The federal budget is one of the most significant factors affecting the size and nature of chartered bank investment portfolios. During the Second World War huge budget deficits were financed in part by the chartered banks. In the first seven years after the war some federal debt was retired, and the growth of the economy brought other potential lenders into the market, so that bank holdings of Government bonds were reduced. Since the mid-fifties, the re-appearance of sizeable Government deficits accompanied by more active monetary policies has led to a greater variability in bank holdings of Government securities.

31. Generally, the further away from cash an investment is, the higher the rate of interest it earns. Hence the management of a bank's investment portfolio usually consists of steering a judicious course between low-yielding "near-cash" assets and higher-yielding less-liquid assets. The most easily realizable assets are day-to-day loans, and Treasury bills issued by the Government of Canada, followed by short-term Government of Canada bonds. Ranked behind these assets, in terms of liquidity, are medium-term Canada's and provincial ~~short-term~~ bonds, longer-term Canada's and provincial bonds, municipal and corporate securities, mortgages, and other assets, but not necessarily in that precise order.

32. Short-run fluctuations in bank deposits and

loans are met primarily by increases or decreases in "secondary reserves" -- day-to-day loans and Treasury bills. Longer-term movements in security holdings are likely to be related to cyclical influences. An upsurge of business generally brings with it a rise in business inventories, an expansion of working capital requirements, and a general drain on the liquid assets of bank customers which causes them to employ more fully their existing lines of credit at the banks or to seek larger lines. The use of monetary restraint in recent periods of strong business activity has meant that at such times the chartered banks have been able to meet increasing customer demands for loans only by selling securities. The process of liquidating securities when the money supply had not been permitted to increase was a factor in a fall in bond prices and a rise in interest rates which spread from short-term securities into medium-term and longer-term bonds.

33. When business is deteriorating, the demand for bank credit and competing forms of credit by the private sector of the economy tends to decline. In recent years the federal government has employed the counter-cyclical device of deficit financing and called upon the banks, directly or indirectly, to take up sizeable new issues of securities, usually with the support of the central bank, which has provided the banks with sufficient reserves to support large-scale buying. Easy monetary conditions imply relatively low rates of interest, so that the banks have often found themselves buying bonds at high prices, knowing that later on they might

have to sell at lower prices in order to accommodate their customers when conditions changed and money became tight. The only way out of this dilemma has been to hold a substantial volume of securities maturing within a short time. Of course this means sacrificing yield for liquidity, so that because of their key role in implementing monetary policy the banks as investors are at a disadvantage relative to other institutions. Experience since the mid-fifties shows that the banks have learned that, given massive Government counter-cyclical fiscal policies and widely varying monetary conditions, their investment portfolios must be shorter than was the case formerly, and that more thought has to be given to anticipating changes in business conditions.

34. How far can the process of selling securities go before a bank feels that its liquidity is at a minimum level? This depends on several factors, which are: the extent of the rise in yields and the concurrent fall in prices and hence the cost of liquidating securities, the anticipated borrowing needs of customers, the size of the portfolio of securities and the speed with which it is being reduced, the attitude of the monetary authorities, and finally expectations regarding all these factors. Experience in the two periods of extreme monetary tightness which occurred in the 1950's suggests that although standards in this respect may change from time to time the banks' portfolios of Government securities at any given period are reducible only within limits, beyond which the banks regard them as essential to the general safety of deposits.

Lending

35. Bank lending policy is formulated by the management of each bank, taking into account market conditions, general economic trends, and changes in monetary policy. Lending policy may be revised, for example, if weakness appears to be developing in a particular industry. Policy changes of this kind reflect the continuous assessment of credit risks which is a part of the process of banking. In addition, however, as the business cycle moves from one stage to another, changes in official monetary policy will produce corresponding changes in the lending policy of the chartered banks. If this latter process is to work smoothly it is necessary that official policies be adequately signalled and clearly understood.

36. Bank lending policy is applied by issuing instructions to credit supervisors at the head office, to the various regional offices, and to branch managers across the country. In this connection it may be noted that the period since 1955 has been the first for a generation in which the branch system has had to adjust to a changing monetary policy. Moreover, on occasion the somewhat obscure nature of monetary policies has made it difficult to determine appropriate lending policies.

37. Other practical problems in adjusting lending policies to changing economic conditons arise because of the difficulty of assessing the meaning of changes in the demand for bank loans in relation to the business cycle: bank loans may rise because business is

improving, or because inventories are being acquired ahead of a real improvement in business, or because sales are falling off and stocks are building up involuntarily. Another problem is that adjustments in bank lending policies, apart from changes in interest rates, take effect primarily through alterations in lines of credit, and thus take some time to have their full effect; it is not possible to review all existing loan commitments at once, and it is difficult for the banks to anticipate the take-up of unused lines of credit. More generally there are difficulties in restraining lending because of the natural tendency of commercial bankers to make good loans whenever possible. The training of branch managers is, after all, aimed at the development of officers who can seek out lending opportunities and make good loans, and the advancement of these officers depends to a significant degree on their ability in making loans.

38. It should be remembered that the Canadian branch banking system has an important degree of built-in flexibility, because behind each branch stand the resources of a large nation-wide institution. This means that, subject to the general availability of funds, each borrower may be dealt with on his own merits without being limited by the position of his local bank branch.

39. The allocation of credit in periods of monetary restraint has become increasingly difficult since the mid-fifties because the general structure of interest rates in the economy has been relatively high and the prime loan rate has been driven very close to

the ceiling. The banks have been forced into a rigid pattern of rates under which almost all borrowers pay much the same rate on loans and the banks are unable to use flexible rates as one of the methods of allocating credit.

40. In the absence of flexible interest rates the problem of allocating bank credit when money is tight becomes one of rationing. When credit is scarce the banks do not usually establish special restrictive policies regarding loans to particular industries, and never do so in respect of loans in particular regions. Certain types of loans are usually curtailed as less essential, such as term loans for projects which could be financed outside the banks, loans to buy securities or real estate for speculative purposes. Loans to other credit-granting institutions are also restricted when money is tight. In the main, however, the process of rationing credit involves reviewing each individual loan account on its merits. It cannot be emphasized too strongly that having to implement a tight-money policy by placing restrictions on individual borrowers, having to choose among equally creditworthy customers, and having in effect to decide which projects may go forward and which may be stopped by lack of funds is a difficult and disagreeable task but one which in the boom phase of the economy sometimes becomes necessary in order to conform with current monetary policy.

41. In the first instance a bank will usually restrict borrowing which appears to be non-essential. When a customer's balance sheet is examined it may appear

that the line of credit which has been asked for is high relative to the size of the business. This may be because the borrower is trying to protect himself against tight-money conditions which he fears may arise in the future, or is asking for a larger line of credit for prestige reasons, or is carrying inventories which are too large relative to sales. In such cases the bank will probably tell the customer it considers that he is asking for more money than he needs.

42. Credit is not rationed on the basis of size of account. The banks have always assumed that their primary responsibility was towards their smaller business customers. The subject of loans to small borrowers has been reviewed with the Bank of Canada on various occasions since 1955 when the first tight-money period began. The withdrawal of the banks from the term-loan field of lending did not apply in the area of small business, and every effort has been made to meet the needs of those borrowers whose size does not enable them to obtain funds by issuing securities.

43. The banks have recently carried out four surveys of loan accounts classified both by industry and by size. The most recent analysis, at September 1961, covers a total of $5,830 millions of loans. Of this amount 32% was in accounts of under $10,000, and 52% was in the accounts of under $100,000. Classified by number, 96.6% of all borrowers were in the under-$10,000 category and only 0.54% had accounts of $100,000 or more. The proportion of total loans made available to smaller borrowers has risen slightly with each survey.

44. It must be realized, however, that in times of extreme credit stringency the banks will be obliged to curtail loans for the purpose of carrying securities or for speculative purposes, and small borrowers in these categories will be affected in the same way as the larger ones, the prime objective being that of conserving lending resources for basic needs.

45. Apart from wartime emergency regulations direct controls on bank lending have not been used very much in Canada, and the banks are not in favour of such controls whether imposed by the central bank or by the Government. We believe that any form of selective controls on bank lending would reduce the flexibility of the Canadian banking system, which has been one of the strongest factors in the growth of the economy, and could not fail to result in injustices to specific sectors of the economy.

46. One of the most distinctive features of bank lending in Canada, which goes right back to the 19th Century, is the legislation which allows a chartered bank to make advances on the security of natural products and goods, wares, and merchandise while they remain in the borrower's possession. This is Section 88 of the Bank Act. Similarly, Section 86 of the Act provides that a bank may lend on the security of a warehouse receipt, and Section 82 makes provision for banks to make advances to oil operators on the security of hydrocarbons in, under, or upon the ground. All these sections were designed to encourage the development of Canadian resources by enabling producers, certain

wholesalers, and manufacturers to borrow more than they otherwise could to meet the essential financial needs of their business pursuits. Parliamentary records show that the same motive was behind subsequent steps in the development of this feature in the banking system. These sections of the Bank Act are a means of providing support in many fields of endeavour to an extent which otherwise would not be practical from the standpoint of prudent banking. This applies particularly to agriculture and what may be termed smaller business enterprise with limited financial resources, and often to business enterprises at an early stage in their development, before they have sufficient resources to qualify them for bank credit in the ordinary way.

47. A recent survey suggests that loans outstanding under these sections of the Bank Act amount to something over $1 billion, or 18% of total general bank loans. Although, because of the fact that there is often more than one type of security behind a given loan account, it is impossible to say what proportion of the loans could not have been made without the use of this legislation, it is likely that most of these borrowers would not have been able to borrow, or would have borrowed at higher rates from other institutional lenders. We believe that these sections of the Bank Act are making an important contribution to Canada's financial system.

48. Because the banks already have well-developed facilities they are able to offer consumer credit at rates which (including service charges) are

more favourable to the borrower than those charged by specialized institutions. In general, the banks have set up these programs to reach a group of borrowers who, while unable to provide collateral in the traditional form, are nevertheless creditworthy, and who wish to borrow for worthwhile purposes usually connected with their homes and families. We believe that consumer instalment credit has become firmly established and that such loans are a logical development of banking services. The extensive branch bank system is highly suitable for providing consumer credit.

49. Mortgage lending is a field from which Canadian chartered banks were barred until 1954 when the banks were permitted to enter the NHA field. In the period from then to 1959 the banks accounted for about 35% of all NHA loans made. In December 1959, however, the maximum NHA rate permitted was raised by the Government to 6-3/4% and, although banks could still process NHA mortgages, counsel's opinion was that they could not do so at a higher rate than 6% because of the legal ceiling on bank lending rates. The result was virtual cessation of NHA lending by the banks, since if they had made mortgage money available at 6% while all other lenders were charging 6 3/4% the banks would have been faced with very large demands for funds and an impossible task of credit rationing. We believe that the legislation should be adjusted to permit the banks to participate in NHA mortgage lending on a continuous basis, at whatever may be the going rate of interest for such loans.

50. We believe that the powers of the banks should be broadened to allow them to lend on mortgage security generally. This would extend the range of customer services and would fit in with the Government's desire to see more mortgage lending on the part of private institutions. The history of banking shows that some proportion of deposit funds may safely be made available for long-term investment. Also the banks have suitable administrative facilities for making mortgage loans across the country, as well as specialized mortgage departments set up at their head offices to handle NHA mortgages. It is further argued that a number of recent Acts of Parliament, especially the Small Businesses Loans Act, have had to make special provision to allow banks to take mortgage security in certain cases. In the conduct of ordinary banking business there are also many occasions where being able to take mortgage security as collateral would make the difference between assisting or refusing a customer.

51. In a related context the powers of the banks to take specific security in the course of lending operations appear to be unduly limited in the light of present-day requirements. For example, the power of the banks to take chattel mortgage security is limited to loans made to an individual on the security of household property (as defined in the Bank Act), with the result that the banks are prohibited from taking such security either on a wider range of goods or in respect of manufacturers' and dealers' inventories. We recommend that the whole matter of existing

limitations on the nature of specific security available to the banks should be reviewed with a view to leaving the banks as free as possible to take such security as the requirements of individual situations might indicate. The result would, we suggest, be an appreciable and useful broadening of the banks' ability to serve the increasingly complex and changing requirements of the business community.

52. An important aspect of the lending activities of the chartered banks is the financing of Canada's external trade. Besides providing the foreign exchange machinery whereby importers pay their foreign customers, the banks provide credit facilities for financing the transactions. In the case of exports this may cover the full period from domestic production operations to final settlement from abroad; in the case of imports it may encompass the time between the signing of a contract to purchase foreign goods and the final sale to the ultimate buyer. For longer-term financing, one to five years, the banks have established the Export Finance Corporation of Canada, Ltd., to assist Canadian exporters in meeting the credit terms offered by foreign competitors. This corporation is in fact a "rediscount bank" to which the chartered banks turn over foreign trade obligations discounted by them for Canadian traders.

53. In order to broaden and improve the facilities and operations of the money market in Canada the chartered banks have given very careful study to the creation of a market in bankers' acceptances. A

detailed study of the techniques and procedures which relate to the bankers' acceptances market in both the United Kingdom and the United States led to the conclusion that neither system could,without considerable variation, readily be adapted to Canadian conditions. As a result bankers' acceptances in Canada will not follow either the New York or the London pattern. As far as possible bankers' acceptances will be drawn in connection with the financing of goods, wares and merchandise of a type described in Sections 18 (1) (f) and (g) of the Bank of Canada Act; will be in large denominations and will be of a self-liquidating nature. It is as yet too early to determine the extent to which Canadian firms will find bankers' acceptances a convenient and suitable medium.

54. The money market dealers will act as principals to purchase and sell bankers' acceptances for their clients. The function of the chartered banks will be to assess the credit worthiness of the drawer of the acceptance draft and, if his is the primest credit, to accept such a draft and return it to the drawer. It is the drawer's responsibility to sell the accepted draft to a money market dealer. Bankers' acceptances will be eligible collateral as security for day-to-day loans in the money market and under Section 18 (1) (b) of the Bank of Canada Act the Bank of Canada has indicated its willingness to deal in bankers' acceptances which have a term to maturity of not more than 90 days. During the initial stages of the development of the acceptance market the chartered banks, in order to assess the

usefulness of this new instrument in the market place outside the banking system, will not themselves purchase acceptances for their own account. It has also been agreed that, after a period of six months from the beginning of the market in bankers' acceptances, the chartered banks will review the experience gained in that interval and make such changes in techniques and procedures as in the light of this experience are necessary or desirable.

Deposits

55. Public attention is, perhaps, most often focused on the lending and investing aspects of banking. But the ability of the chartered banks to carry out their lending functions adequately depends on the way in which the banks perform, or are permitted to perform, as deposit institutions. Chartered bank deposits fall into two major classifications, demand deposits and notice deposits, in proportions which have varied over time. Notice deposits amounted to roughly two-thirds of total Canadian deposits in 1930 and 1935. By 1945 they had fallen to under 50%, but have since risen to about 60% of the total.

56. Besides the deposits of corporations and individuals, "demand deposits" include those of governments and other banks. They perform two closely related functions in the economy, that of a store of liquid value, and that of the chief medium of payment in Canada. The volume of payments made by cheques on current accounts in the chartered banks has increased much more rapidly than

the level of the deposits themselves. In the post-war period, the annual turnover or velocity of demand deposits has increased from 24 times in 1945 to over 68 times in 1961. This increase has not only posed problems for the banks in the operating procedures needed to handle the heavier flow of cheques, but also presented a problem to the community in the exercising of monetary policy, resulting in the need for more vigorous central bank action.

57. The growth of demand deposits since 1935 has not kept pace with the rise in Gross National Product, nor has it followed a steady pattern from year to year. Rather, in response to central bank action, demand deposit growth has tended to follow a counter-cyclical pattern, particularly in the post-war period.

58. While demand deposits represent, in general, the "working capital" of individuals, organizations, and companies, notice deposits are more likely to represent their reserves held pending a major expenditure or with investment in view, as a cushion in case of emergency, or simply the accumulation of savings built up over the years. The chartered banks have long been the most important savings institutions in Canada and, at latest count on September 30, 1961, they had over 10.8 million personal savings accounts on their books. While the total of such deposits has increased faster than demand deposits in the post-war period, their growth, like that of demand deposits, has tended to follow a counter-cyclical pattern. Much of the growth of savings deposits has been encouraged by the rapid increase in the number of branches

operated by the chartered banks, which has enabled them to reach a wider proportion of the population. However, the growth of savings deposits has not kept pace with the rise of G.N.P. in Canada. This is a reflection, not of a lower propensity to save on the part of Canadians, but rather of the growing importance of other savings institutions.

59. To meet the competition for the surplus funds of corporations and institutions the banks in recent years have issued deposit receipts for funds left for fixed periods of up to one year, and one of the banks now issued negotiable term notes with maturities of up to six years. While they are used principally by corporations and institutions, these deposit receipts and term notes are also available to individuals and executors or trustees of estates.

60. The turnover of savings and other notice deposits is much lower than that of demand deposits. In view of the greater stability and lower velocity of notice deposits, suggestions have been made from time to time that the chartered banks might quite properly engage in a much larger way in longer-term financing. However, from the community's point of view the over-all problem is to achieve a balance in the total supply and demand for financial resources. It has been the function of financial organizations, especially the banks, to receive the savings and working capital of the community for varying terms and to apportion them as loans or investments at short or long term as circumstances warrant. We are opposed to any attempt to segregate deposits by

term or type because the result would be to introduce undesirable rigidities into the financial system.

Foreign Currency Business

61. Canadian chartered banks provide a full range of international banking services, including the maintenance by some banks of branches, agencies, and representative offices abroad. This is a natural corollary of the great importance to Canada of international trade. If Canadian banks were not able to provide the whole range of banking services necessary for carrying on an extensive import and export business, Canadians requiring these services would have to obtain them from foreign bankers. Canadian banks are able not only to meet Canadian needs in this respect, but also to compete successfully with foreign banks for additional international business. The provision of international banking services is a field in which there is intense competition and it is essential that Canadian banks have great flexibility in their foreign operations in order to be able to meet such competition. The success of Canadian banks in this area of activity means an important net contribution to the credit side of Canada's balance of payments. The foreign currency business of banks arises out of transactions with foreign countries including imports, exports, investment, payment for services, tourism, and remittances of all kinds. The operations involve all types of transfers, cheques, drafts, currencies, bills of exchange, and commercial letters of credit. The banks in Canada are also active in the forward markets for the key currencies, U.S. dollars and

sterling, and for all the other free currencies in which there is forward trading.

62. In recent years substantial deposit and lending markets have developed for U.S. dollars and sterling outside their countries of origin. These types of deposits and loans are commonly referred to as Euro-dollars and Euro-sterling. In addition to the normal requirements of importers and exporters and other customers requiring foreign deposits, such factors as differential interest rates and anticipations regarding the exchange rate have contributed to the development of these markets. Canadian banks have entered actively into this highly competitive area of banking, particularly with respect to U.S. dollar deposits. Such deposits do not of course leave the United States but remain within that country for use there. The growth of such deposits has not of course been confined to Canadian banks, since institutions in other countries have been competing aggressively for these deposits. It should also be noted that Canadian funds may flow into foreign banks in the same way, depending on interest rates and anticipations regarding the exchange rate. In general deposit liabilities are offset by assets in the same currency, hence the risk of an exchange position is avoided. In short, this is a field of international operations where there is intense competition and where Canadian banks have had considerable success. It is, however, an area where deposit and lending rates are quoted at very narrow spreads, allowing little margin for losses, commissions, and the costs related to

reserves. Any restrictions on Canadian operations in this field would increase costs and give a decisive competitive advantage to non-Canadian banks.

Banks in the Securities Business

63. Chartered banks make an important contribution to the capital financing of major new projects in Canada through their participation in syndicates set up to handle the underwriting and distribution of securities. They usually provide the preliminary short-term financing and are in a key position to assist in making the transition to long-term financing. They work closely with investment dealers in endeavouring to ensure that capital issues are properly designed, taking into account the interests of both sellers and buyers. With their widespread network of branches banks are particularly well placed to assist in the distribution of securities across Canada, and they have made it a point to ensure that their customers in all parts of the country have an equal opportunity to obtain a share of new issues, insofar as the banks' participation in such issues will permit.

Revenues and Expenses

64. The revenues of the chartered banks are derived principally from two main sources: from interest on the use of their financial assets - loans, securities, etc. - and from charges made to customers for services rendered. The latter source has declined in relative importance in the post-war period because rate schedules have remained largely unchanged and increases in such revenue have depended principally, therefore, upon the

growing volume handled. From the other source of earnings - interest on financial assets - there have been increases in both rates and total volume. In addition, during the post-war period loans have grown at a greater rate than investments; while investments exceeded loans in 1945, the position now is reversed. Loans generally earn higher rates than investments, so the relatively greater expansion of loans has contributed to the improvement in earnings.

65. The most significant increase in bank costs in point of size has been the rise in interest expense. This has resulted from the expanded deposit base, from a shift from non-interest bearing deposits into interest-bearing, and from a considerable increase in rates paid on deposit balances. Other items of expense including salaries have also risen, but remain in about the same proportion to each other.

66. The result of these trends in bank revenues and expenses has been a considerable increase in net earnings in the post-war period. However, it appears unlikely that the chartered banks will be able to increase the rate of return on total assets much above present levels. The post-war shift from low-yielding securities to higher yielding loans, however, seems to be approaching an end with the ratio of risk assets to deposits near 70%. At the same time the shift from non-interest-bearing to interest-bearing deposits has shown no sign of slowing down.

Capital

67. The capital funds of a bank are used to

supply the physical means of doing business, to ensure the protection of depositors' funds, and to enable the banks to engage in international operations. While capital has grown in absolute amount, the proportion of capital in relation to deposits or to risk assets is considerably less than it was 30 years ago. Not only has there been a large increase in bank holdings of Government bonds and in Government-guaranteed loans, but also the operations of the central bank in providing liquidity have reduced the relative need for capital compared to that maintained in the 1920's and 1930's. This trend, of course, is not restricted to Canada and is evident also in both the United States and the United Kingdom.

68. The banks at present have some 85,000 shareholders. This is an increase of 50,000 since 1944 when, in accordance with the Bank Act revision of that year, stocks were split ten for one. It seems to us desirable that widespread ownership of shares in the banks should be encouraged, and the price of each share should not be so high that small investors find them inconvenient to buy. We therefore recommend that the shares should be sub-divided again.

Inner Reserves

69. Basically the inner reserves of the chartered banks are a cushion against the contingencies of the future. Their size, however, is currently governed by a formula which uses the average loss experience for the past 25 years. It thus produces the anomalous result that good years push the allowable percentage down at the very

time when reserves should be built up, and conversely a period of high loss experience permits a higher allowable percentage when reserves are actually being depleted. It is the opinion of the banks, therefore, that the present formula should be supplemented by a specified "floor", which would prevent the ratio from falling below an adequate level.

70. The important function of inner reserves is to provide out of current earnings for unforeseen banking losses that are almost sure to be incurred in future years. As explained very clearly by the Ministers of Finance during both the 1944 and 1954 Bank Act Revisions the chartered banks depend more than any other institution on the confidence of their depositors. At the same time they are expected to take the risks inherent in carrying on a lending function. They can carry out this function most effectively if their management feel they can absorb the unusually high losses that occur in some years without losing the confidence of their depositors.

71. As for the non-disclosure of inner reserves it can be said that in banking the interests of depositors are paramount. The reputation for stability of the Canadian chartered banks is a national asset of the first importance to the community in general, and it is certainly not in the public interest to endanger this reputation either at home or abroad.

72. The history of the years after 1929 demonstrates the public advantage of the banks being able to present a reasonably stable position in a time of

violent and sudden stress, and it seems to us desirable therefore that the banks should be permitted to maintain a buffer of undisclosed reserves.

FINANCIAL COMPETITION AND CONTROL

Competition Among Banks

73. Competition from other lenders and other deposit institutions keeps bank deposit and loan rates and other charges closely in line with the overall structure of competitive rates, though there is some scope for variation because bank loan and deposit facilities are associated with other banking services that must be paid for in one way or another. Among the chartered banks themselves however competition must take a different form. The various banks offer a virtually identical range of services to the public, and no one bank has a monopoly of staff and facilities capable of performing these services in a courteous and efficient manner. It is obvious that any bank will have to meet the best rate offered by other banks in any major category of service, otherwise it will lose virtually all of its business in that line; there is therefore little scope for differences between banks in respect of interest rates or charges. For example, if the interest rate structure is considered unbalanced, there may be some question as to whether it is lending rates or deposit rates that should be changed. Almost invariably the bank which is willing to operate at the rate most favourable to its customers sets the pattern for all the others; no one bank or group of banks could

long continue to exact terms less favourable than any one bank or minority of banks was prepared to offer.

74. Banks compete vigorously for both lending business and deposit business, where much depends on personal relationships and personal judgment. They compete in attracting new enterprises, both domestic and foreign, and assist newly established businesses in a number of ways. Specialized knowledge of and service to particular industries are other forms of competition, and include the provision of information to customers in various forms.

75. The provision of a network of well-located branches is undoubtedly one of the major forms of competition among banks. A wide and efficiently distributed network of banking offices has always been essential to any banking system in rendering service to its customers, and never more so than today. Branch banking as it has developed in Canada has shown itself capable of meeting this need admirably. It brings the full range of banking services to the newest community without delay. It has also been successful in meeting the demands of the dispersal of population and industries around the peripheries of major cities, and the development of new industrial areas. This phenomenon is perhaps less spectacular then the enlargement of our geographic frontiers, but it is a pervasive movement that is affecting a much larger proportion of all bank customers.

76. The decision to open a new branch in a given location is based on a variety of considerations.

It must fit in with the needs of a balanced geographic distribution of branches across the country. The prospects for business growth in the general area to be served must be carefully examined. The particular site must be convenient to existing and prospective customers. The number and location of branches of other banks near by and of other branches of the same bank must be considered, for there is no profit in entering an area that is already over-banked no matter how promising it is in other respects. No branch is expected to be profitable from the start, though this does happen in exceptional cases. Generally speaking, however, a new branch is expected to begin earning a profit within three to five years.

Entry into the Banking Business

77. Traditionally in Canada entry into the banking business has been carefully regulated under the Bank Act in the interests of ensuring a sound and reliable system. In earlier days the statutory provisions with respect to minimum capital requirements and the scrutiny of the authorities were doubtless the major obstacles to be overcome. Nowadays, however, even if a group wishing to found a bank had little trouble raising the minimum capital required and assuring the authorities of their good faith, they would find it difficult indeed to win a sizeable share of the Canadian banking business unless they could rapidly build up a trained staff and a wide network of branches. The amount of capital and the organizational work involved in so doing are surely a far more powerful deterrent than the

statutory requirements.

78. If we look no further than the performance of banks chartered under the Bank Act, there seems to be little justification for modifying the provisions that now apply to entry into the banking business. The need for sound and responsible banking practice is more pressing, not less, in a complex modern society. Many of the techniques devised in other countries to improve and strengthen their banking systems have been in large part to achieve what was already characteristic of Canadian banking; others have already been adopted in Canada; none of them offers any reason for reversing the traditional pattern of our banking legislation. By any objective comparison with other countries, Canadian banking must be rated highly.

79. However, if we broaden our view to take in the performance of banking and quasi-banking functions by other financial institutions, a somewhat different picture emerges. Experience over the years has led to the imposition of stringent controls over the chartered banks to ensure that they are soundly operated and that depositors' funds will remain liquid in times of financial crises -- special provisions concerning shareholders' audit, rigid internal inspection, and supervision by the Inspector General of Banks; the detailed provisions of the Bank Act in relation to formation, management, and winding up; limitations on the activities in which banks may engage; and so on. This provides a formidable armoury of safeguards under federal legislation. To a somewhat similar extent the same situation,

in respect of legislative safeguards, applies in the case of the two institutions operating under the Quebec Savings Bank Act, a federal enactment broadly modelled on the Bank Act. Yet many other financial institutions now hold large portions of the liquid savings of the public under conditions not greatly different from those which applied to banks in the days before the development of modern safeguards to protect the depositor. It may even be that the very success of the measures for assuring strong and sound banks has lulled the authorities and the public alike to the dangers of unregulated banking. Our forefathers had intimate practical experience with these dangers, but this generation has not. In any case the tradition of safety built up by the chartered banks has made it easier for the near-banks to grow without actually having to provide to the public the financial protection that is nowadays taken for granted.

Competition with other Financial Institutions

80. The Role of the Chartered Banks. The Canadian chartered banks have traditionally been the chief depositories for personal savings and have also been the chief source for most kinds of short-term business financing and personal loans. In addition, they have long played an important rule in government financing as purchasers of Government of Canada securities, and more recently they have provided a foundation for the growing Canadian money market, which depends in a substantial degree on the fact that the chartered banks keep a secondary reserve in the form of day-to-day

loans to money market dealers and Government of Canada Treasury bills. Under the National Housing Act, until the going rate of interest went above the maximum permitted the banks, they made a substantial contribution to residential mortgage financing, a field otherwise prohibited by the Bank Act. Since the establishment of the Bank of Canada, monetary policy has also been implemented primarily through the effects on chartered bank operations of variations in bank cash permitted the chartered banks by the Bank of Canada. The operations of the chartered banks are also regulated in detail by the terms of the Bank Act, as well as by certain of the terms of the Bank of Canada Act. Among the key points of these controls are the statutory limitation of 6% in the rate which may be charged for bank loans, the statutory requirement to hold 8% cash against Canadian deposit liabilities, together with the supplementary agreement on secondary reserves, and the prohibition under the Bank Act of acquisition by the chartered banks of certain types of assets, notably conventional mortgages.

81. Development of Other Financial Institutions

Over the years a considerable number and variety of other financial institutions have developed in Canada in competition with the banks. Although none of these other institutions offers a full range of banking services, each of them has taken on some functions and services of an essentially banking nature. To the extent that these other institutions may have developed by providing services and facilities which for one

reason or another the chartered banks did not provide, the result may be regarded as a desirable growth in the range and flexibility of financial services in Canada, although it has also produced problems in the field of monetary policy for which solutions are needed. However, to a very considerable extent, these competing institutions have made such rapid headway in circumstances in which the chartered banks were prevented by legal or other rigidities from competing effectively. It might also be pointed out that some of these institutions enjoy freedom from income taxation.

82. The major functions of a banking nature performed by these other institutions are primarily the acceptance of savings and other deposits in various forms from the community; the extending of loans for a wide variety of purposes; the provision of the equivalent of chequing services, made possible in practice by access to the chartered banks' clearing system; and the provision of safety deposit boxes and other safekeeping services. These functions are performed without the limitations enforced on the chartered banks by the Bank Act, the Bank of Canada Act, and certain "agreed" arrangements with the Government and the Bank of Canada. "Banking" is not defined in our legislation and various possible definitions, from the point of view of economic analysis, are in varying degrees inadequate or misleading. However, from the point of view of monetary policy these institutions are important instruments for the expansion of credit in the economy and, as such, their operations directly affect the success or failure of monetar

policies even though they are not, like the chartered banks, directly amenable to control in the interests of official monetary policy.

83. Among these competing institutions are credit unions and caisses populaires, finance companies, small loan companies, factoring companies, trust and mortgage loan companies, Quebec savings banks, provincial government savings offices, and the Post Office Savings Bank. These institutions are all competing actively for the savings or loanable funds of the community, and many have greater freedom than do chartered banks in the way in which they can invest such savings and other funds, and therefore in the returns which they can pay to lenders and depositors. Government of Canada Savings Bonds are also a very important savings instrument involved in the general competition for the community's savings.

84. Competition for Savings. Competition for the liquid resources of the community has intensified in the post-war years. The chartered banks' share over this period has declined from 87% of the given total in 1947 to 74% in 1960. This continuing relative decline is of importance to the chartered banks, and may have serious repercussions on the economy. If this trend had been the result of free and unrestricted competition among the financial institutions involved, the public interest would have been served. This has not been the case, however, as the banks do not enjoy the same freedom as their competitors. The expansion of total chartered bank deposits is regulated directly by the

central bank in the interests of counter-cyclical monetary policy. No such direct influence is exercised over deposits in competing institutions. Indeed, during recent periods of monetary restraint, when chartered bank deposits were being held down by central bank action, total deposits in the near-banks continued to expand rapidly. For instance, during the two years 1959 and 1960, while chartered bank deposits rose 1.8%, deposits etc. in Quebec savings banks, credit unions, government savings institutions, trust and loan companies, mortgage companies, and finance companies, rose 27%. (Investment by the public in Canada Savings Bonds rose by 24% in the same two-year period.) The banks are at a disadvantage in attracting deposits because of limitations on their ability to pay rates of interest on deposits comparable to those paid by near-banks.

85. Implications for Monetary Policy. Under present conditions, as competing forms of financial claims grow relative to chartered bank deposits, monetary policy has either to become more broadly directed against the total supply of liquidity or progressively more vigorous on chartered bank deposits in order to bring about a given expansion or contraction of total money expenditure. When monetary policy is restrictive heavy pressure is placed upon the banks which is not shared by other financial intermediaries. Consequently, under these conditions the near-banks can and do expand at a time when the chartered banks are required to restrict their growth. It follows, under these circumstances, that the central bank is forced to be even more

restrictive as the chartered banks' relative position declines.

86. Discriminatory Restrictions on Chartered Banks.

Each of the limitations of a discriminatory nature on the activities of the chartered banks has an inhibiting effect on the competition the chartered banks are able to offer these other financial institutions. Each of these limitations, therefore, contributes to reducing the sources of financing available to the Canadian public.

87. The 6% legal maximum interest rate is perhaps the most important. This ceiling may once have reflected public attitudes that were more understandable in the past, but in present circumstances it is difficult to find a rational explanation for it. A very large volume of bank lending is, in any case, done at rates lower than the legal maximum. This indicates that banks, like other financial institutions, must meet the going rates in each of many areas of financing. The rates charged reflect the nature of the risk, the costs of doing the business, and other relevant factors, including the vigorous competition of other banks and other institutions. In some areas of financing the going rates are often above 6%. These rates too reflect such factors as risks and costs but it is quite conceivable that they are in fact higher than they might be if chartered banks were allowed to compete at rates which would give them a fair return but which might well be less than is now charged by lenders shielded from such competition. Chartered banks would

also, of course, be in a position to pass on to their depositors an appropriate share of any benefits resulting therefrom.

88. While the ceiling on bank lending rates has remained at 6% since 1944 other institutions, including the Industrial Development Bank as well as mortgage institutions and caisses populaires, are all charging more than 6% on loans at the present time. Although the cost of borrowing money from the banks is normally very small in relation to the total costs of doing business, the cost of long-term funds from other sources for such projects as utilities and pipelines is a decisive element in the total cost and often determines whether or not the project can be carried out. Yet there is a price ceiling on the first category of lending, and an open market without any legal limitation for the second category.

89. The practical impact of the 6% ceiling on bank lending rates was demonstrated most acutely in the summer of 1959. As the Treasury bill rate rose towards 6% it became theoretically possible for bank customers to borrow at the prime rate and invest the funds in other short-term securities at a profit while the banks were liquidating these very securities in order to make loans. At the same time large business customers who had been raising funds for short-term working capital from non-financial institutions while market rates were lower than the rates charged by the banks, suddenly found that the prime rate of the chartered banks was lower than the cost of alternative accommodation.

Some of these customers proceeded to draw down bank lines of credit which had not been used for months or years, so that the banks found themselves with a sharp increase in the demand for business loans at the same time that the demand for other kinds of credit was also extremely strong. The 6% ceiling in this case not only prevented the banks from using the traditional device of raising prices to moderate demand but actually intensified the demand itself.

90. The interest rate rigidity has also had a profound effect on what has traditionally been one of the main features of the operations of Canadian chartered banks, i.e., the attraction of savings deposits. In the last ten years the rate of growth of savings in a variety of competing institutions has been much greater than in the chartered banks. The chief reason has been that these other institutions, since they are able to invest a very substantial proportion of their total assets in higher-yielding investments, notably conventional mortgages, are likewise in a position to pay a higher return on savings obtained from the public. This results in a progressive limitation on the resources available to the chartered banks for lending and investment activities, and in fact makes it possible for funds to be attracted to depositories not always subject to appropriate safeguards.

91. It is sometimes argued that, provided these other institutions continue to maintain their cash balances in the chartered banks, the only result

of this shift of savings deposits is a change in the ownership of the deposits in the chartered banks - with deposits from trust companies, etc., replacing those of individual owners of savings deposits - and that the cash reserves of the chartered banks are in any case regulated by the activities of the Bank of Canada, so that there is no necessary reduction in the lending and investing capacity of the chartered banks as a result of this drain of savings to other institutions. In fact, of course, the decisions of the central bank authorities as to the cash reserves to be allowed the chartered banks, and hence the decision as to the amount of financing the chartered banks are to be allowed to do at any time, must take into account the volume of financing being done outside the banks. If free competition were established between the banks and the other institutions, and if as a result the banks began to attract a growing share of savings deposits, and were in a position to compete for a share of the higher-yielding investments now taken by these other institutions, the decisions of the central bank as to chartered bank cash would undoubtedly take into account the larger requirements of the chartered banks. There is, in short, no way of avoiding the fact that the loss of deposits to competing institutions affects the chartered banks in exactly the same way as the loss of business affects any other commercial institution.

92. The primary and secondary reserve requirements, imposed only on the chartered banks, amounting in total to 15 per cent of deposit liabilities, are a

further important limitation on the freedom of action of the chartered banks in their efforts to make the most effective use of their resources in competition with other financial institutions. Cash reserves, as a miminum percentage of deposit liabilities,were originally intended as a safeguard to the depositors, i.e. to the general public. With the present structure of inspection and supervision, both by the banks themselves and by the Inspector-General of Banks, appointed by the Federal Government, this is no longer the main purpose of cash reserves. The normal working requirements of the banks would dictate some level of cash reserves whether or not any legal requirement existed. The 8% legal cash ratio, however, introduces a rigidity not faced by competing institutions. A further rigidity is introduced by the undertaking to hold secondary reserves in the form of Treasury bills and day-to-day loans to money market dealers in amounts such that these assets together with cash are equal to 15% of deposit liabilities. This is not in a true sense a reserve, since it is not available for use; rather is it a forced investment. Thus, regardless of alternative investment opportunities which may well be more attractive at any particular time, the chartered banks are under the obligation to maintain substantial holdings of normally low-yielding assets. The consequence of these arrangements is that the chartered banks, alone among financial institutions, must pay a substantial direct cost, in the form of lower returns on their assets than would otherwise be available, as part of the current

arrangements for implementing the Government's monetary policy and to facilitate, through the money market, the implementation of the Government's fiscal policy.

93. These reserve requirements are a basic element in a further restriction on the ability of the chartered banks to compete effectively with other institutions, namely the fact that monetary policy in Canada is implemented by actions which bear directly on the cash position, and hence the financing opportunities, of the chartered banks, and only indirectly, if at all, on the financing opportunities available to competing institutions. Since these other institutions do not have statutory cash reserve requirements and are not bound by the 6% interest rate maximum, they are able, during a period when the authorities wish to contract or restrict the growth of credit, to continue to expand their credit operations and to take advantage of whatever may be the prevailing rate of interest. Since the central bank does not have the power to control their operations, even tighter restrictions have to be imposed on the chartered banks in order to keep the total amount of financing in the country within the limit desired by the central bank authorities. This is clearly a serious defect in the arrangements for implementing monetary policy, and one which imposes special costs and restrictions on the chartered banks, substantially limiting their ability to compete effectively.

94. Another important legal limitation on the competitive position of the chartered banks is the prohibition in the Bank Act of lending on the security of

mortgages, with the exception of those insured under the National Housing Act. This prohibition means that the public is largely prevented, when seeking mortgage money, from approaching the chartered banks as one possible source of the funds required. The field is therefore left open to a range of other lenders who are inhibited neither by government regulation nor by the possibility of competitive action by the chartered banks.

95. Conclusion. What should be the goal of national policy in this whole matter of the type and variety of financial institutions available to serve the Canadian economy? It is our view that the goal should be to have a wide range and great flexibility in the financial services available to the Canadian public and that this can best be achieved by permitting the free play of competitive forces among the various institutions involved, including the chartered banks, without discriminatory restrictions which work to the disadvantage of one type of institution. At the present time the chartered banks are prevented by various legal and institutional rigidities from competing fully and effectively with other institutions over the whole range of financing activities. This means that the Canadian public, in seeking to satisfy its various financial requirements, frequently finds that for certain of these requirements the chartered banks must be ruled out as possible suppliers. The result is that for a considerable range of financial activity the other institutions are sheltered from the competition which could

otherwise be available from the chartered banks and which could not fail to strengthen the position of the Canadian public as it weighs and compares alternative sources of financing.

96. So far as possible the solution should lie in the direction of allowing free competition and the play of normal market forces as between competing financial institutions. Some regulations and controls there will undoubtedly be, intended either to safeguard the interests of the public or to facilitate the implementation of official monetary and fiscal policies. To the extent that this is practicable and possible, such controls and regulations should bear equally on all competitors in the field. From the point of view of competition with near-bank institutions, the preferable solution to the legal maximum interest rate problem would appear to be to give the banks the same competitive flexibility now enjoyed by the other institutions, i.e., to eliminate the legal maximum; and the banks so recommend. This, particularly if combined with the removal of limitations on lending powers, would permit the chartered banks to compete on equal terms with other institutions now attracting a rapidly growing share of the savings deposits and loanable funds of Canadians.

97. It may here be pointed out that in 1933, by a four-to-one majority, the Royal Commission on Banking and Currency in Canada recommended the repeal of the statutory provision limiting the banks' lending rates. The four Commissioners expressed the opi

"that a staturory maximum rate of interest is nowadays anomalous and an undesirable interference with freedom of contract, and that the provision of the Bank Act limiting the rate of interest to seven per cent, whatever justification it may originally have had, ought now to be repealed." This recommendation was not acted upon, and in fact the ceiling was subsequently lowered to six per cent.

DEBT MANAGEMENT

98. In the period since the 1958 conversion loan there have been a number of changes in debt management policy and techniques. Although we are satisfied on the whole with the way debt management has been developing recently, it is open to some criticisms. The increased role of the Bank of Canada in taking on large blocks of new issues which are fed out to the market according to demand has been accompanied by more or less overt attempts on the part of the authorities to influence the selling behaviour of the dealers by inducing them to withhold new short-term issues from the banks and offer them instead to the non-bank market. This behaviour on the part of the authorities indicates preconceived ideas on their part regarding the appropriate maturity structure of the banks' portfolios. It is probably fair to say that the banks are unanimous in deprecating this practice. Even though it may generally be desirable to channel securities into non-bank hands it is our view that, once the terms of an issue have been decided upon, the market should operate

freely in determining its distribution as between bank and other investors. Any other view of the market would imply the creation of rigidities and barriers between different types of investors, which would inhibit rather than assist the growth of an effective market.

99. On the technical side the Bank of Canada has been accused of erratic behaviour in its after-market operations with those parts of new issues which it has taken up itself. The criticisms relate to the Bank's hours of trading, amounts of bonds offered at different times, and prices quoted. We are inclined to think that the Bank of Canada is seriously handicapped in its operations by being geographically separated from and out of touch with the major markets in Toronto and Montreal. The situation would be improved if the Bank were to maintain senior officers in both centres with sufficient authority to make on-the-spot decisions.

100. We believe that the system of Treasury bill auctions has worked well on the whole. In the past it has been suggested that all transactions should be put through dealers, and that banks should not bid directly for bills at the tender. We would not be in favour of such a change, as we think it important that the banks keep in close and active touch with the money market.

101. We believe that the federal debt should continue to be managed by the Department of Finance, using the Bank of Canada in an advisory capacity only. We would not be in favour of setting up an independent

body to make debt management decisions. Debt management techniques, however, would probably be improved if either the Department of Finance or the Bank of Canada were to consult banks and investment dealers and institutional buyers on a regular basis, as is done in the United States before the timing and terms of Government issues are decided.

Techniques of Monetary Control

102. Cash Management. To exercise control over the volume of bank credit, the central bank has only to regulate the supply of bank cash relative to the needs of the banking system for cash. The central bank, through its control of bank cash, can provide the banking system with surplus cash at any given moment, thus permitting the system to expand. Or, the central bank can withdraw cash from the system leaving it with less cash than it requires, thus forcing the system to contract.

103. The best known technique that the central bank has for managing bank cash is open-market operations. These have the davantage that they can be made to operate smoothly and continuously so as to tailor cash changes as precisely as possible to fit the day-to-day needs of monetary policy. Other ways in which a central bank can supply or withdraw cash from the banking system are by extending the scope of its lending operations and by movements in government or other accounts carried by it. All these other methods of cash management are less satisfactory than open-market operations for they do not work through the market mechanism and they have an

element of arbitrariness. They cannot be carried out as precisely as open-market operations, and they are less easy for the public to understand. Consequently it is preferable for a central bank to concentrate on open-market operations as its main instrument of cash management, resorting only to other techniques in situations in which the state of the money market restricts the use of open-market operations.

104. Reserve Requirements. In order to impose control over a banking system the central bank requires as a minimum the ability to supply or withdraw cash from the banking system. Another aid is often called upon to help in maintaining control over the banking system, namely, statutory cash reserve requirements. Such requirements work automatically to dampen fluctuations in bank deposits and assets.

105. Other Monetary Control Techniques. A liquid asset ratio is also sometimes introduced as an aid to monetary control. Such a ratio may be necessary when ordinary techniques of central bank cash management cannot be used to reduce the cash base of the banks, or to prevent them from adding to their loans, as for example if the central bank is prevented from using open-market operations to maintain control over the banking system because of its concern for stable interest rates or for government financing. In such a situation, which is one in which the money market is not adequate for the open-market operations the central bank would like to carry out, a liquid-asset ratio may be a useful stop-gap measure. A better solution than the

adoption for all time of a liquid-asset ratio, however, would be to find ways of developing a better money market. In the meantime a liquid-asset ratio should be retained for no longer than necessary, and there is certainly no need to give such a ratio legal status.

106. Other schemes besides cash or liquid-asset requirements could no doubt be devised as a means for implementing and aiding monetary control. Such requirements, however, are unnecessary when money markets are sufficiently developed to permit the central bank to exercise control through open-market operations. Hence, the emphasis in monetary control should be on bettering financial markets for making open-market operations more effective rather than devising new methods of control. Then the central bank will be able to exercise monetary control effectively by working on the supply of bank cash, using its open-market operations for this purpose.

107. Bank Rate. "Bank Rate", the minimum rate at which the Bank of Canada is prepared to make loans or advances, might be used to perform one or both of two distinct functions: to regulate the access of the money market to the central bank, and to provide a signal of central bank intentions. The present method of setting Bank Rate in Canada at 0.25% above the latest average yield on accepted tenders for Treasury bills performs the first or "penalty rate" function satisfactorily, for it makes borrowing from the central bank a more expensive way of raising cash than selling marketable securities or borrowing elsewhere, but it

does not perform the second or "signalling" function.

108. The effect of monetary control depends in no small part on the responsiveness of the banking system. In all systems there will be some lag between a change in monetary policy and the response of the banks and the public at large. In other words, there is more to central banking than merely pushing a button to move the banking system from one position to another. It follows that the response of the banking system to central bank control will be more rapid and appropriate if the banking system is informed of the direction in which the central bank is trying to move it. Therefore, a signal of central bank intentions adds to the efficiency of monetary control.

109. It is certainly important for a central bank to offer full explanations of its policy. The complexity of the modern financial environment makes it all the more imperative that the maximum of information be provided. But more than this is required for implementing monetary control. Bank Rate is the most widely accepted means of signalling central bank intentions. Qualitative statements and explanations while useful do not replace the need for indicating policy in terms of some significant economic or policy indicator. For such purposes statements concerning the money supply, national income, general prices, etc. to indicate intentions are too general, and these indicators are not sufficiently amenable to the control of the central bank to be a good signal. The level of bank cash is a better signal but is not as good as

Bank Rate itself.

110. The basic problem in using Bank Rate as a signal is to do so without compromising its function as an appropriate penalty rate, which serves to restrict access to central-bank loans for last-resort situations. The present method of setting the Rate does not solve this problem. A return to the conventional Bank Rate, fixed at the discretion of the central bank, may not solve it either. Having two rates, one as a signal and one as a penalty, is a possible solution. Another possibility is to continue to use a floating rate but to vary the spread between Bank Rate and the Treasury bill rate. Yet another possibility is to retain the floating rate in normal circumstances but to depart from it as necessary in order to provide a signal.

111. Bank Lending Rates. Under existing conditions of financial competition, flexible bank lending rates would serve as a useful means of furthering the needs of monetary policy. In order to do this, however, the legal ceiling would have to be eliminated. Under present legislation when banks are unable to meet all the demand for loans their allocation of the inadequate supply of funds is made more difficult because they cannot make appropriate increases in lending rates. If the ceiling were removed the banks could pay more to their depositors, and would be able to compete more effectively with non-bank lenders, thus contributing to better monetary control.

112. Tied or Linked Rates. It has been

that bank lending rates or deposit rates, or both, should be tied to a conventional Bank Rate functioning as a signal of central-bank intentions along the lines of arrangements in England. Such arrangements are not as desirable as they may seem at first glance, and in fact they have serious disadvantages which lead the banks to oppose them. By its very nature Bank Rate at times will move ahead of the market and at other times will lag behind it, and any other rates tied to it would then be out of line with the market. Market forces cause bank lending and deposit rates to move more or less together anyway, but the spread naturally varies over the business cycle in a way that helps to stabilize monetary policy, and introducing a fixed spread would introduce unnecessary rigidities into the system. In any case it would place the chartered banks at a new competitive disadvantage if their lending or borrowing rates were linked to Bank Rate while the rates of other institutions were left free to move with the market.

CONCLUSION

113. The banks have welcomed the opportunity provided by the preparation of this brief to make the thorough review of their basic functions that this enquiry involves. Such reviews are not by any means new to the banks because of the necessity of preparation for decennial revisions of the Bank Act. Nevertheless, on this occasion, when banking is being considered in the broader context of its relationship to the functions of other financial institutions, an introspective look

at the role of banking takes on a special significance.

114. In making the observations and recommendations embodied in the brief, the underlying theme is the desire of the banks to maintain those basic standards of banking procedure which have earned for the Canadian banking system an enviable reputation for stability and soundness, while at the same time seeking to achieve a more flexible framework of operations within which the changing financial requirements of a developing Canadian economy may more fully be met.

115. In keeping with this approach we have made no specific recommendations in this brief regarding other financial institutions. Our preoccupation has been with the desirability of removal from the banks of what now appear to be outdated and unnecessary restrictions. This is not to under-emphasize the necessity of fundamental legislative and procedural safeguards, but, given the existence of these fundamental safeguards, it is our belief that the public interest will best be served by the widest possible area of flexibility for banks and other institutions alike.

AO

SUBMISSION

to the

ROYAL COMMISSION

on

BANKING AND FINANCE

JULY - 1962

THE CANADIAN BANKERS' ASSOCIATION

THE CANADIAN BANKERS' ASSOCIATION

The Canadian Bankers' Association is the Association of the eight Canadian Banks chartered under the Bank Act. Its Executive Council is composed of the general managers of these banks. The members of the Council at the time of filing this brief and their offices in the Association are as follows:-

President

R.D. Mulholland	Bank of Montreal

Vice Presidents

J.P.R. Wadsworth	Canadian Imperial Bank of Commerce
Leo Lavoie	The Provincial Bank of Canada
J.D. Gibson	The Bank of Nova Scotia
C.B. Neapole	The Royal Bank of Canada

Members of Council

A.E. Hall	The Toronto-Dominion Bank
Louis Hebert	Banque Canadienne Nationale
D.C. Langford	The Mercantile Bank of Canada

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INTRODUCTION

In recent years there has been considerable progress in understanding the role of finance in modern society. It is the hope of the Canadian chartered banks that the facts and opinions set out in this brief will help the Royal Commission on Banking and Finance in its enquiry into these matters, to the benefit of Canada as a whole.

Much of the statistical and explanatory material in the pages which follow has been compiled on the basis of experience with questions that are likely to be asked during Bank Act revision proceedings and similar enquiries. However, it should be pointed out that part of the material has been included in answer to detailed and searching questions asked by the staff of the Commission itself, in the course of discussions with representatives of The Canadian Bankers' Association. The chartered banks welcomed these enquiries and have endeavoured to deal fully with the important issues raised.

Nevertheless this brief does not pretend to offer definitive answers to all the questions it raises, because these matters carry well into areas where value judgments must be made between alternative objectives and where it would be neither possible nor desirable for the chartered banks as a whole to speak with one voice. Accordingly they have presented a common viewpoint wherever possible, and where specific recommendations are made such recommendations carry the support of the

banks generally. On the other hand where there has been a division of opinion on substantial matters the brief acknowledges it and endeavours to summarise the major viewpoints.

PART ONE

THE ROLE OF FINANCIAL ORGANIZATIONS

SECTION I

POLICY OBJECTIVES AND INSTRUMENTS

The Objectives of Monetary Policy

1. The preamble to the Bank of Canada Act reads:

> Whereas it is desirable to establish a central bank in Canada to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion ...

Although written over a quarter of a century ago, this statement is still remarkably apt. Perhaps the only major change needed to reflect current thought would be an explicit reference to the objective of sustained economic growth.

2. Reporting in 1959, the Radcliffe Committee in the United Kingdom listed as objectives in pursuit of which monetary policy might be used:

(1) A high and stable level of employment.

(2) Reasonable stability of the internal purchasing power of money.

(3) Steady economic growth and improvement of the standard of living.

(4) Some contribution, implying a margin in the balance of payments, to the economic development of the outside world.

(5) A strengthening of London's international reserves, implying further margin in the balance of payments. 1/

3. Two years later the Commission on Money and Credit in the United States, under the heading "National Economic Goals", stated that:

> An adequate rate of economic growth, sustained high levels of production and employment, and reasonable stability of prices are clearly the three objectives of central concern for monetary, credit, and fiscal policies. These three goals, however, must be sought in the context of other important national objectives .... (including) national security.... harmonious international economic relations and contributions to economic development abroad .... economic freedom....(and) an equitable distribution of opportunity and income.....2/

1/ United Kingdom, Committee on the Working of the Monetary System, Report (London, Her Majesty's Stationery Office, Cmnd. 827, 1959), para. 69.

2/ Money and Credit, the Report of the Commission on Money and Credit (Prentice-Hall Inc., Englewood Cliffs, N.J., 1961), pp. 9 - 10.

4. Both these reports point out that the attainment of the various goals may interfere with one another. The U.S. report states that "no single economic goal can be wholly unqualified, because each may have to be sought subject to constraints imposed by other goals or at costs representing sacrifices, to some degree, of other goals." 3/ The Radcliffe report follows up its list of objectives with this paragraph:

> In listing these five objectives, we have to acknowledge that there are serious possibilities of conflict between them. The choice between, where choice has to be made, is one that Governments have to face. The freedom of Governments in making these choices is not absolute. It is limited by the importance of each of these objectives to the continuous and orderly life of society. The immoderate pursuit of one or several of these ends at the expense of another may place an intolerable strain on the body politic. To pursue the other desirable objectives, cost what it may in terms of unemployment, or to sacrifice all reasonable stability of the value of money in an attempt to realize the remaining objectives, are examples of the ways in which society could be disrupted. 4/

3/ *Ibid*, p. 10.

4/ *Op. cit.*, para. 70.

5. These descriptions of economic objectives are remarkably parallel. In summary, it may be said that the most generally accepted goals are full employment, stable domestic prices, healthy economic growth, and a sound and dependable relationship between the domestic economy and the world economy of which it is a part. In pursuance of these objectives it may be taken as a general principle that the methods used should be those of the normal price and market mechanism as far as possible, or at least should be compatible with the effective operation of that mechanism.

Monetary and Fiscal Policies

6. Monetary policy and fiscal policy are generally thought of as the two main instruments available to the authorities for pursuing the major economic objectives described above. When properly used they are compatible with the price and market mechanism; indeed, smoothly operating financial markets are important to the optimum effectiveness of both monetary policy and fiscal policy.

7. Monetary policy may be defined as the use of central banking techniques to influence the general level of business activity. The aspect of it that is most familiar is central bank control over the level of the chartered banks' deposit obligations, which constitute the main part of the money supply. Of course control of bank deposits also means control of the total volume of the loans and investments of the banks.

8. The essence of fiscal policy is the management of the total amount of government revenues, the total

amount of government expenditures, and the difference between them, as a device for regulating the pace of business activity.

9. Monetary policy decisions and fiscal policy decisions, separately or in combination, should be framed so as to balance investment demand with the flow of savings the community generates when operating at full capacity. The flow of goods and services through the production lines to the ultimate consumer is controlled and directed by the flow of money payments in the opposite direction (the spending stream), and the income of individuals and businesses is generated as part of the spending stream that keeps the production lines moving. The point at which the community's saving and investment decisions are brought together is particularly vulnerable. These decisions are made by quite different groups of people, and for different reasons, yet some way must be found to keep the decisions in balance, otherwise the smooth flow of the spending stream will be interrupted. If the demand for borrowed funds (say, to invest in new productive enterprises) is greater than the rate at which the community tends to save at a given level of income, expansionary forces will be generated; if the rate of saving tends to exceed the demand for borrowed funds, there will be contractionary forces.

10. Monetary policy operates basically by influencing private decisions to invest or to save. It does so primarily by altering the size of the cash base of the economy, but also to some extent by making it

easier and cheaper to borrow, if investment needs stimulating, or by making it dearer and more difficult to borrow, if investment needs to be restrained. It should be noted, however, that the interest differential tends to press more heavily on social capital borrowing than on borrowing for commercial purposes, in part because of the impact of the corporate income tax. Changes in interest rates are supposed to encourage saving and low interest rates to discourage saving, though there is some dispute about how effective this influence is.

11. Fiscal policy, on the other hand, operates by using a budgetary deficit as a substitute for private investment, or a budgetary surplus as a supplement to private saving. As we know it today fiscal policy may be said to have originated as an aid to monetary policy, because in the 1930's easy money and low interest rates alone had proven inadequate to stimulate recovery. For a while, however, it seemed to have completely swallowed up monetary policy. In the 1950's monetary policy staged a more or less world-wise revival, but probably we have yet to see the optimum use of the two techniques working as a team rather than as alternatives.

Limitations of Monetary and Fiscal Policies

12. One of the most obvious limitations of monetary policy, already referred to, is that it may fail to stimulate investment sufficiently in times of serious recession. The interest rate that the investor would have to pay for borrowed funds is not the only factor involved in a decision to invest, and may

not be a significant factor if there is any doubt about the profit possibilities of the investment. Thus monetary policy is permissive rather than decisive in such circumstances; it can be effective in restraining an inflationary boom, but it may fail to stimulate expansion from a depressed economic position.

13. One of the great virtues of monetary and fiscal policies is that they tend to be general in their incidence. That is to say they operate on the total spending in the economy, without any marked effect on particular sectors, and they offer a minimum of interference with normal market forces. But this very virtue implies a corresponding limitation, namely that they may be blunt and imprecise. They cannot be used to give selective stimulus or restraint to a particular region or sector of the economy.

14. As stimulants to expansion, monetary and fiscal policies can often be effective when the problem is one of re-employing people who have been thrown out of work by a short-term recession. In this circumstance there are productive units ready to resume operations, skilled operatives ready and willing to get the production lines going, and so on. The major requirement is to get money flowing back into the hands of consumers; they are likely to spend it, and that is enough to get the wheels of industry rolling faster again.

15. Monetary and fiscal policies by themselves can do much less to expand production into new and untried fields, even if there are substantial reserves of

unemployed labour and potential productive capacity. This can be clearly seen for example in many of the developing countries today, but it also occurs to some extent here in Canada in relation to efforts to expand production beyond previous levels or into new lines. Such expansion requires initiative, capital, management, new labour skills, perhaps new skills in finance and marketing and various other fields, as well as access to raw materials; and all of these requirements must be brought together in the form of actual going concerns of economically efficient size. Suitable monetary and fiscal policies can do much to promote a favourable climate for developments of this kind, but they are not sufficient by themselves to overcome the various problems involved.

16. However, there is another major limitation on monetary and fiscal policies, and this applies to the already developed countries as well as the developing countries. It is rooted in the fact that any national economy is part of a world economy in which international trade is extensive and pervasive. International trade confers major benefits in a great many ways, for the international division of labour is one of the foundation stones of the high standard of living the western world has achieved. Nevertheless it does inevitably make each country dependent to a considerable extent on conditions in other countries, and limits the independence of domestic policies in important ways. It means for example that a part of the Canadian spending stream is directed abroad, and a part of

Canadian income originates in spending by foreigners on Canadian exports. This complicates the application of monetary and fiscal policies in two ways: (1) it introduces a new possibility of imbalance in the spending stream, in that income originating abroad may not be in balance with income spent abroad; and (2), unlike saving and investment decisions, foreign spending on Canadian products cannot be directly influenced by the level of domestic incomes or liquidity.

17. Foreign trade has important implications for national monetary and fiscal policies. The international division of labour means that the domestic price structure must be kept in line with the price structure in other parts of the world. This is particularly clear for the prices of internationally traded goods such as wheat, newsprint, and base metals, which are of major importance to Canada. However, the same is largely true even for domestic goods that do not cross any international boundaries in search of markets, partly because of the competition from imported goods, but also because wages and other costs in domestic industries are influenced by wages and costs in export industries owing to the mobility of labour and other resources. The result is that an expansionary monetary and fiscal policy will be less effective when domestic costs are out of line, because a substantial portion of the increase in spending will be channeled into imported goods and will not add directly to domestic income.

18. It may be noted that the interest rate structure must be considered as part of the price structure from

this point of view. The interest rate is the price that must be paid for the use of someone else's capital, and capital is one of the most international of international commodities. Assuming equal economic and political stability, domestic interest rates cannot get very far out of line with interest rates in other countries without causing capital movements that may force a change in domestic policies. For example, an easy-money policy in one country during a recession might reduce interest rates so far below those prevailing in other countries that it would cause an out-flow of funds and either drain exchange reserves or unduly depress the exchange rate. Or a tight-money policy designed to combat domestic inflationary pressures might raise interest rates enough to attract unwanted funds from abroad, which would reinforce the inflationary pressures or threaten an appreciation of the exchange rate.

Other Policy Instruments

19. It is quite possible that there is too much concentration on monetary and fiscal policies, as if they were the only means of promoting the desirable economic objectives discussed earlier. In point of fact there is a wide range of additional measures that can be employed to good effect, for example, public debt management, taxation policy, commercial, tariff and exchange rate policies, and measures to encourage increased productivity. However, this brief must be concerned primarily with monetary matters.

SECTION II

THE FINANCIAL ORGANIZATION OF THE CANADIAN ECONOMY

The Role of Finance

20. The financial system plays a complex and essential role in the modern economy. It provides the means of payment, in the form of bank notes or deposits subject to chequing, through which the price and market system works. It offers a means of remitting funds or collecting funds from distant places, either within the country or abroad. To the saver it offers a wide choice of outlets for the employment of accumulated savings and facilities for keeping them safe from loss or theft. To the creditworthy borrower it offers a wide range of sources of funds, from which he can normally expect to make whatever arrangements will best suit his needs. It also offers still other services, such as insurance, estate management, and so on.

21. Another major function of the financial system is to mediate between those who do not wish or are not able to invest their savings directly in physical assets and those who draw on the savings of others to supplement their own resources. A substantial portion of this mediation takes place through the arrangement of loans or the purchase and sale of securities between principals, either in direct negotiation or in transactions through investment dealers and brokers on organized or over-the-counter markets; it may involve the issue of new securities or loan contracts or other types of financial claims, or trade in existing

claims. Another major portion takes place through various financial institutions, such as banks, trust companies, mortgage loan companies, credit unions, insurance companies, finance companies, small loan companies, factoring companies, and others, which receive funds from one group and lend to another and accordingly may be described as financial intermediaries.

22. The importance of effective financial organization is implicit in the need to maintain a balance between the community's investment demands and the flow of savings it tends to generate when all its resources are fully employed, as explained in Section I. Any tendency to imbalance in this relationship will make itself felt in financial terms, and so must any measures taken to correct such a tendency. Both monetary and fiscal policies operate by influencing one side or the other of this relationship as reflected in the supply of and the demand for financial claims. Sound and responsive financial institutions and financial markets are thus essential to the use of these policies for promoting Canada's major economic objectives.

23. Until fairly recent years it was generally held that banks were categorically different from other financial institutions in that the former could "create" credit whereas the latter could only re-lend funds entrusted to them. Even today there are those who maintain this position. However, an increasing number of economists now hold the view that credit "creation" is not peculiar to the banking system, but occurs in basically the same form in various parts of the

financial structure. The emphasis is placed on the general liquidity of the economy, not on the quantity of money alone. It is argued that the total resources available to the capital market and to all financial institutions combined is determined by the laying aside of financial savings out of income, and that the allocation of these resources to banks and to other financial institutions is determined by the free choice of savers in deciding how to employ their savings. The distinction between banks and other financial institutions lies not in any mysteriously different source of resources but in the ready acceptability of bank deposits by spenders and savers alike; bank deposits are a particularly attractive form of liquid asset because they are a means of payment and hence are useful not only as a savings vehicle (liquidity motive) but also as working balances (transactions motive).

24. It is of course technically true that the Canadian banking system can expand its assets (in the form of loans and investments) and its liabilities (in the form of deposits) but only within limits fixed by the amount of cash reserves the Bank of Canada allows them. However, the banks themselves cannot determine these limits. It is entirely up to the national monetary authorities to decide what level of bank deposits is appropriate.

25. It is unnecessary to attempt to resolve these theoretical arguments here, however, important though they may be in themselves; the reason for raising them is primarily to indicate the complexities of using

monetary and fiscal policies for the promotion of the major economic goals described in Section I. The object of the authorities in using these policies must be to maintain a balance between the economy's investment demands and its rate of saving at optimum levels of income, taking account of the limitations of these policies themselves. This means maintaining the smooth flow of the spending stream as a whole. From this point of view it makes no difference whether a loan-financed expenditure is made possible by the expansion of the money supply (quantity of money) or by more intensive use of the existing money supply, (velocity of circulation) for both affect the spending stream. It is clear therefore that the authorities should be concerned with all forms of credit, including that granted by other financial intermediaries as well as by banks and including that obtained through the money and capital markets.

26. The type of lending business carried on by the various financial intermediaries should not be determined by arbitrary rules, but should be left to the play of market forces and natural specialization. Institutions with long-term contracts predominating among their liabilities, such as life insurance companies and pension funds, may be expected to seek relatively long-term outlets for their funds, including bonds and mortgages, though of course they will need some shorter-term and therefore more liquid assets as well in order to allow for unexpected variations in their cash flows. Institutions that are designed to provide

specialized forms of credit, on the other hand, such as finance and factoring companies, etc., may try to raise funds through contracts with maturities more or less comparable to their loan contracts. In general, however, there is no compelling reason for having precisely matching maturities in the borrowing and lending contracts of the same institution, provided a liquid reserve is maintained that is adequate to the risks involved and provided the asset "mix" is appropriate to the fundamental nature of the business.

27. In the case of banks it was formerly thought necessary that they should confine their loans and investments to short-dated maturities, because their obligations are usually repayable on demand. Nowadays, however, it is recognized that it is feasible for them to put a limited portion of their funds into longer-dated loans and investments. Nevertheless it remains true that the first priority in bank lending must still be given to short-term business borrowing for working capital purposes, because the banking system in Canada, as in most other parts of the world, developed in response to these needs and there appears to be no other source similarly qualified to provide, administer and supervise this type of loan.

<u>The Role of the Banking System</u>

28. Banks are clearly financial intermediaries, and clearly have a special role to play in the functioning of the financial system. However, while "a bank" in popular understanding is a specific and readily identifiable type of institution, it is not easy to

find a satisfactory definition -- a problem that is by no means peculiar to Canada. The Bank Act gets around the difficulty by defining a bank as "a bank to which this Act applies" (sec. 2), i.e. "each bank enumerated in Schedule A (sec. 4)", but that leaves the real question unanswered.

29. One possibility would be to define a bank by describing its activities. Among its essential features are that it accepts deposits repayable on demand or short notice, some or all of which are normally transferrable by cheque, 1/ and lends or invests the funds deposited with it. Other services which are normally performed by banks and which are commonly thought of in Canada as typical banking functions include foreign exchange transactions, buying and selling domestic or foreign bills of exchange, the collection of clean or documentary bills, remittances, cheque clearing, issuing letters of credit, giving financial guarantees, safekeeping of securities or other valuables, rental of safety deposit boxes, and so on. However, there is hardly a single one of these services that is not offered to the Canadian public by some financial institution other than a chartered bank.

30. Another possibility would be to define a bank as an institution having liabilities that are generally acceptable for making and receiving payments, such as bank notes or chequing deposits. This is what

1/ Canadian law defines a cheque as a bill of exchange drawn on a bank and payable on demand. In common usage however the term is used to include similar bills drawn on other financial institutions.

distinguishes "money" from "near money" in most theoretical treatments, and there is some logic in identifying the money-providing function with banking.

31. However, it seems impossible to define banking in a way that meets universal acceptance. In what follows, unless otherwise indicated by the context, the word "bank" will be synonymous with "chartered bank" and will be used in the sense in which it is defined in the Bank Act.

32. Just as one of the recognized key functions of a central bank is that of lender of last resort for the commercial banking system, so the commercial banks in turn perform a similar function for other financial intermediaries, though this is probably less well understood. These institutions typically carry working balances with the banks, just as other businesses do. They also customarily maintain lines of credit with their banks, whereby they are able to borrow on short notice within agreed limits. In this way they are able to operate with minimum working balances and yet with reasonable assurance of being able to meet any unexpected demand for funds. The liquidity of the entire financial structure thus depends largely on the liquidity of the banks.

33. Modern views of the respective roles of banks and other institutions within the financial structure differ, substantially from those of even a generation ago, and indeed one of the most important tasks before the Royal Commission may be that of putting these relationships in better perspective. Without trespassing

on the ultimate findings of the Commission in this respect, however, it may be said that the present-day questioning of older ideas in this field does not detract from the key role of the banking system in maintaining a balance between the saving and investment decisions of the community. When business is slack the almost universal acceptability of bank deposits by savers and lenders alike assures the community of whatever degree of liquidity may be necessary to sustain business operations. In times of inflationary boom the dependence of a community on money as the means of effecting transactions offers the authorities a powerful and flexible weapon for keeping the volume of spending in line with the physical volume of goods and services becoming available.

34. For their part Canadian banks from earliest days have recognized the need to co-operate with official financial policies in the public interest. They recognize this need no less now, because of the key position of the banking system in carrying out such policies and promoting economic stability.

Criteria of Performance

35. Determining whether the financial system is performing adequately or otherwise at any given point of time must necessarily involve subjective judgments to a substantial extent. It is particularly difficult at times to distinguish shortcomings that are attributable to the system itself from those that are attributable to particular policies being pursued by the authorities or by major public or private institutions.

What has so far been said about the role of finance does suggest some reasonably objective criteria, however, which should at least be helpful in forming such judgments.

36. One useful criterion is the success of official policies in achieving the major economic goals listed in Section I. If these goals are being reached reasonably successfully, there is a *prima facie* case for supposing that the financial system must also be working fairly well; if not, then the financial system should certainly be examined, along with other aspects of the economy, to see if any improvements can be made.

37. Whether the economy as a whole is working well or ill, however, there are certain minimum standards that should be met by the financial system. The supply and demand for funds in each of the various sectors of the money and capital markets should be kept in balance fairly smoothly, without sharp fluctuations in security yields or interest rates. The differential between the rates in various markets should be reasonable in the light of the underlying differences in the nature of the contracts involved, including differences in costs of administration or supervision, differences in maturity, and differences in risk. Differential advantages or disadvantages for certain classes of borrowers or lenders, or for the financial institutions through which they customarily obtain or employ their funds, should not be permitted to occur unless clearly necessary in the public interest. Further, the policies of all types of financial institutions should be in

harmony with the public interest, even if that requires some sacrifice of their particular interests; the financial system must clearly serve the public, not the other way round.

38. Finally, and with particular respect to the role of banking in the economy, it is submitted that the public interest is served by the existence of a strong banking system. A bank is more than a repository of deposits on the one hand, and a medium for making loans and investments on the other. The fact that the deposits entrusted to the chartered banks are the banks' liabilities to the public is an accounting truism, but its real significance tends to be overlooked or taken for granted. Not since 1923 has there been a bank failure in Canada. Thus, for a generation, no Canadian has lost a night's sleep worrying about the safety of his "money in the bank". Indeed, the Canadian banking system enjoys a world-wide reputation for soundness and stability, and this in itself has been a factor of no small significance in the nation's ecomomic development.

PART TWO

THE OPERATIONS OF THE CHARTERED BANKS

SECTION I

RESERVES

Reserves

39. Each chartered bank is required by s.71(1) of the Bank Act to "maintain a cash reserve in the form of a deposit with the Bank of Canada and of Bank of Canada notes held by the bank, and such reserve shall be not less on the average during any month than eight per cent, or such other percentage as may be fixed by the Bank of Canada under the provisions of the Bank of Canada Act, of such of its deposit liabilities as are payable in Canadian currency". These requirements are an average for the month, and at any moment of time within the month a bank may have either more or less than enough cash to meet its legal requirements.

40. In November 1955 the chartered banks acceded to a request by the Governor of the Bank of Canada that in addition to the prescribed cash reserve each bank would hold day-to-day loans and Government of Canada Treasury bills in such amounts that the total of cash, day loans, and bills would average not less than 15% of deposit liabilities throughout each month, effective in June 1956.

Management of the Cash Position

41. Management of [illegible]

bank is a matter of keeping the cash on hand adjusted to the cash needs and wants of the bank. In deciding how much cash it should be holding at any moment of time, a bank will be influenced by the number of business days left in the month, by the state of the money market, and by any cash gains or losses anticipated before the end of the month. For example, if a new month has just started, if there are limited opportunities for acquiring money-market assets at profitable rates, and if large cash losses are expected to occur later in the month, a bank may well be content to hold for the time being more cash than it needs to meet its legal requirements. Conversely, if cash gains are expected to occur later in the month, a bank may be satisfied to hold for a short time rather less cash than would otherwise be the case. Considerations such as these, as well as legal requirements, thus determine the amount of cash a bank will want to hold at any given moment.

42. It is a head office function to see that the cash on hand is kept adjusted to the current cash objectives of the bank. If the cash on hand exceeds minimum foreseeable requirements in relation to the objective, the bank will immediately try to invest the excess. If the cash on hand falls short of the objective, the bank will try to raise, as cheaply as possible, the cash necessary to make good the deficiency. In this way the bank tries to avoid holding more cash than it has to or to avoid letting its cash fall below its objective. In short, cash management in a chartered

bank is the art of trying to keep the amount on hand adjusted to the objective of the bank day by day throughout each month.

43. The task is a complicated one, for the cash a bank can count on having is affected by many variables or unknowns. Each business day a bank makes the first computation of its cash position around 10 a.m., after getting the results of the Montreal and Toronto clearings. At this time it does not know for sure how its cash will be affected by such things as the clearings in Western Canada, the results of which come in later during the day, or by currency shipments taking place between its branches and the Bank of Canada that day. Yet if the bank wishes to make an adjustment in its cash position that day it is more or less compelled to act on the basis of the early morning figure. Cash management must also take into consideration known or anticipated changes in large accounts, the volume and timing of the foreign-exchange transactions that the bank has to carry out, and the state of activity in the money market. All these elements add to the difficulty of ascertaining the exact amount of cash firmly held by the bank and the extent to which cash losses or gains are temporary or permanent.

44. Once a bank concludes that it has too much or too little cash, it acts as fast as it can to remedy the situation. To do so it must deal in assets that can be easily purchased or sold for cash in substantial volume. In Canada these properties are normally possessed by day-to-day loans to money-market dealers, by Treasury

bills, and by short-term Government of Canada securities. By using these assets, in lieu of trying to find buyers or sellers for less actively traded assets, a bank can usually keep its cash supplies adjusted to its cash needs smoothly and rapidly. However, the extent to which a bank can reduce its holdings of Treasury bills and day-to-day loans is limited by the undertaking to meet the 15% liquid asset ratio. In case of need the banks may borrow temporarily from the Bank of Canada while making more permanent adjustments.

45. If a bank finds it is continually accumulating liquid assets after accommodating current loan demands, it will at some stage begin to switch out of the liquid assets into less liquid ones seeking more profitable uses for its funds. In the opposite case, where it is continually disposing of liquid assets to meet daily cash deficiencies, the bank will be forced sooner or later to dispose of less liquid assets, either to raise cash or to restore holdings of liquid assets, and eventually it will have to adopt a more restrictive lending policy.

46. How quickly a basic trend in the cash position of a bank influences its investment and lending policies depends on the stock of liquid assets held by the bank, the rate at which the stock is changing, and the view of the bank of the intentions of the central bank. If a bank knows that it is the intention of the central bank to maintain a given degree of pressure or restraint in the current economic environment, it will move much faster to adjust its investment and lending policies

than it will if it is uncertain about central-bank intentions. In the end the timing of the ultimate response to a basic change in the cash position of a bank depends to a very large extent on the bank having a clear understanding of central-bank intentions.

The Present Method of Calculating Cash-Reserve Requirements

47. From the point of view of the chartered banks it is desirable that legal cash-reserve requirements be specified in a way that does not add to the uncertainties and difficulties in managing their cash positions. In terms of these criteria the present method of setting the requirements is satisfactory.

48. The formula for determining the amount of the cash reserve required to be maintained by a bank during any month is contained in s. 71(2) of the Bank Act:'

> 71 (2) For the purpose of determining the amount of the cash reserve required to be maintained by a bank during any month
>
> (a) the amount of its deposit liabilities payable in Canadian currency shall be the average of such deposit liabilities at the close of business on Wednesdays in each of the four consecutive weeks ending with the last Wednesday but one in the preceding month,
>
> (b) the amount of Bank of Canada notes held by the bank shall be the average holdings of such notes at the close of business on Wednesdays in each of the four consecutive

weeks ending with the last Wednesday but one in the preceding month, and

(c) the amount of its deposit with the Bank of Canada shall be the average amount of such deposit at the close of business on each juridical day of the current month.

Thus each chartered bank's reserve requirement for each month is based on figures for a previous period and is therefore known in advance.

49. The present method of fixing the reserve requirements in advance for the next reserve period has been criticized on a number of grounds. It has been pointed out that changes in the reserve base, and so in requirements, may at times be quite abrupt, requiring similarly abrupt intervention by the central bank if it wishes to maintain the same degree of ease or tightness of reserves. Such abrupt changes might also affect the money market by causing unrealistic swings in interest rates which could be misinterpreted. It is contended as well that the present method does not cause requirements to change fast enough when all banks are expanding simultaneously. In any one month the banks could expand in step and would face no restraint from a rise in requirements until the following month. It is asserted that tying bank reserve requirements to the latest deposit figures would make monetary policy more effective because any increase in deposits would bring an immediate deficiency in the cash position, and the banks would react as if the central bank had taken cash away from them. We do not agree with these

assertions.

50. As the requirements stand at present the central bank can readily counter any unwanted expansion or contraction almost immediately by open-market sales or purchases of securities. If for example there is an expansion because the banks are adding to their holdings of marketable securities the central bank could offset it by selling securities. If on the other hand the banks are adding to their loans the effects will not show up in the open market, at least not immediately, but in the deposit liabilities of the banking system. If the central bank sees deposits rising when it would prefer them not to rise, it can withdraw cash from the banking system to counter the expansion.

51. Whether an automatic change in the cash position, caused by a rise in requirements, is to be preferred over a discretionary cash change, produced by the central bank selling securities when it sees bank deposits rising, depends primarily on whether the automatic cash change would occur faster than the discretionary change. If the central bank did not receive deposit figures until much later than do the individual chartered banks, there would clearly be merit in favouring automatic cash changes. Under Canadian conditions however deposit figures are available to the central bank almost as soon as they are to the individual chartered banks.

52. Another criticism of the present formula for setting reserve requirements is the length of the averaging period, i.e. a calendar month, which is

alleged to cause the banks to be sluggish in response to their daily cash position. Rapidity of response, however, also depends on the instruments available for adjusting bank cash and on the volume of transactions that the market in those instruments can handle. The shorter the reserve period the better the market has to be and the greater the variety of instruments required. A shorter period would make it more difficult for a bank to carry out its cash adjustment transactions in the money market. On the selling side it would have to bunch its transactions more, and on the buying side it might have to forego some transactions because of limitations in the market. In other words, shortening the reserve period does not necessarily lead to faster responses.

53. If the averaging period were shortened, however, the present restrictions on chartered bank borrowing from the Bank of Canada to make advances to each bank are normally limited to a specified amount somewhat resembling an established line of credit; these limits have not been changed in many years notwithstanding the substantial increase in banks' assets and liabilities. Each advance or renewal of an advance is made for a fixed period of seven days. The first advance in any calendar month up to the specified amount bears interest at the Bank Rate. However, a second advance to the same bank in any calendar month, or a renewal of an advance, or an advance in excess of the specified amount, bears interest at some unspecified higher rate and is subject to negotiation. [illegible]

limitations interfere with the traditional role of the central bank as lender of last resort.

54. Moreover, a "Bank of Canada Funds" market would probably be a prerequisite for overcoming the difficulties that would ensue. A "Bank of Canada Funds" market, in which banks could sell their excess cash with the Bank of Canada to banks in need of cash, could be introduced, as in the New York money market where there is active trading in "Federal Funds". Whether such a market should be introduced even under the present method of calculating reserve requirements depends on the ultimate effect it would have on the money market. We are not opposed to such an innovation, but we believe that it would inhibit the development of the money market.

55. On balance we consider the advantages of fixing the cash reserve requirement in advance and averaging reserves over a calendar month outweigh the disadvantages. We recognize that in the public interest bank credit policies must conform to the requirements of monetary policy with reasonable promptness, but we feel that any proposed change should be clearly justified in advance, especially if it would add to the burdens that are imposed on the chartered banks and only on the chartered banks.

56. Another aspect of the present arrangements for cash requirements that the Commission may wish to consider is the minimum level of 8 per cent for the legal reserve ratio. The rapid growth of financial institutions outside the banking system makes this a particularly

relevant question. Too high a reserve ratio puts the banks at a cost disadvantage compared with these other institutions which are not hindered by legal-reserve requirements in bidding for business. A smaller ratio would not impede monetary control and would contribute to a more competitive financial system.

57. The size of the ratio is of some significance to monetary policy as well. The central bank presumably reacts to the sum total of economic activity, including financial activity inside and outside the banking system, in pursuing both its short-run and its long-run objectives for the economy. Accordingly, any growth in near-bank financial institutions appears to be taken into account by the central bank in regulating the size of the chartered banks' cash reserves. Thus, the central bank will evidently keep the cash reserves of the chartered banks from being as large as they otherwise could be, and the size of the control base on which the central bank acts will therefore be smaller, when other financial institutions are growing. If any of the growth is the result of other financial institutions having a cost advantage over banks in being free of reserve requirements necessitating holding more cash than would otherwise be held, it follows that the higher the reserve ratio imposed on banks the smaller the banking system will be. It would not seem to be in the interest of efficient monetary policy to let the control base shrink simply because the reserve ratio was set higher than it need be.

SECTION II

INVESTMENTS

Purposes of Investment Portfolios

58. One of the primary functions of a chartered bank is to make loans. It follows that bank investment activities are normally subsidiary to bank lending activities. Since loans vary as a result of seasonal, cyclical, and irregular influences, a chartered bank must be able to adjust other earning assets up and down fairly readily in order to accommodate its borrowing customers and the investment portfolio permits this to be done, while employing the residual funds profitably.

59. A large proportion of deposits (about 40%) is in current accounts which are legally payable on demand, and most of the balance is in personal savings deposits which in practice are also paid on demand, even though notice could be required. Because of the large number of accounts involved, the deposits of an individual bank tend to remain relatively stable in relation to the total level of deposits in the system. However, over short periods of time a bank's deposits can be adversely affected by substantial withdrawals, as cheque payments are made by customers of that bank to customers of other banks, without an equal volume of offsetting transactions happening to go in theother direction. Under such conditions one bank can lose cash in the net clearing of funds while others gain. Such clearing fluctuations have become more pronounced since the broadening of the money market which commenced in 1954.

The large corporate depositor moves his funds about in a variety of short-term instruments, and a fortuitous combination of several large transactions can have a substantial effect on the cash position of a single bank. In order to meet any conceivable cash withdrawal, large or small, on demand and without the slightest qualification as to its immediate availability, a bank must have readily realizable investment assets in addition to cash itself.

60. Generally, the further away from cash an investment is, the higher the rate of interest it earns. Hence the management of a bank's investment portfolio usually consists of steering a judicious course between low-yielding "near-cash" assets, and higher-yielding less-liquid assets. To be a "near-cash" asset in this sense, an asset should be not only readily saleable, but also saleable in quantity without significantly depressing the price. Almost any asset can be sold fairly quickly if the price is low enough, but few assets can be sold within the day. The most easily realizable assets are day-to-day loans, and Treasury bills issued by the Government of Canada. Ranked behind these assets, in terms of liquidity, are short-term Government of Canada bonds, medium-term "Canada's", provincial short-term bonds, longer term Canada's and provincial bonds, municipal and corporate securities, mortgages, and other assets, but not necessarily in that precise order.

61. It might be argued that commercial loans themselves are more liquid than many of the above investment assets, in that they are nominally callable

on demand. In practice, however, a chartered bank does not "call" loans from its customers for reasons of general liquidity (except for day-to-day loans to the money market), and would be extremely loath to do so.

62. To give a balanced structure to the bank's assets, which is important for a flexible bank lending policy and for maintaining the confidence of the general public and of customers at home and abroad, the weight of risk assets must be balanced by a proportion of relatively riskless assets (riskless in the credit sense, though not necessarily in the market sense), such as securities of the Government of Canada. Other investments, such as provincial and municipal bonds, and corporate securities, have varying degrees of risk, though generally speaking the degree of risk on any of them is considered less than on most commercial loans. Even this is not always the case, as a commercial loan to a strong corporation is often less risky, and sometimes more realizable, than an investment in some municipal or corporate obligations.

63. In the maintenance of their investment portfolios the banks do from time to time participate in the financing of federal, provincial, and municipal governments, and to a lesser extent of corporations. As national savings institutions, the banks share in the task of providing funds for the financing of both current and short-term capital requirements of all three levels of government. The federal budget is one of the most significant factors affecting the size and nature of chartered bank investment portfolios. Dur[illegible]

Second World War, huge budget deficits were financed in part by the chartered banks. In the first seven years after the war some federal debt was retired, and the growth of the economy brought other potential lenders into the market, so that bank holdings of Government bonds were reduced absolutely and also relative to other bank assets which expanded under peacetime conditions. Since the mid-fifties, the reappearance of sizeable Government deficits accompanied by more active monetary policies has led to a greater variability in bank holdings of Government securities.

64. The foregoing paragraphs surely demonstrate that the employment of surplus funds is a matter of continuous concern to the management of the banks, as is the maintenance of the combination of earning assets most appropriate to any given period of time. Such assets are normally in excess of the bank's liabilities to the public and therefore the often-heard claim that the banks have "idle savings deposits" is a complete mis-statement of fact.

Bank Investment Portfolios and the Business Cycle

65. As discussed earlier, short-run fluctuations in bank deposits and loans are met primarily by increases or decreases in "secondary reserves" -- day-to-day loans and Treasury bills. Such fluctuations relate mainly to day-to-day movements in net clearings of deposits between banks, to short-run changes in cash reserves brought about by the actions of the Bank of Canada, and to seasonal and special influences, such as those related to changes in the public demand for bank

notes or by the payment for large new security issues.

66. Longer-term movements in security holdings are likely to be related to cyclical influences which affect all banks rather than individual banks. An upsurge of business generally brings with it a rise in business inventories, an expansion of working capital requirements, and a general drain on the liquid assets of bank customers which causes them to employ more fully their existing lines of credit at the banks, or to seek larger lines. In recent periods of this kind the banks have been able to expand both their loans and their total assets only as long as the Bank of Canada has been prepared to expand the total cash reserves of the banking system and hence the total supply of money. When the expansion of the money supply has been brought to a halt by the central bank the chartered banks have been able to increase their loans only by selling securities. The process of liquidating securities when the total volume of bank deposits was constant, or rising only slowly, was a factor in a fall in bond prices and a rise in short-term interest rates, since buyers of securities did not appear except at lower price levels. In some circumstances the federal budget might have been expected to act as an offsetting factor, if under good business conditions the budget had swung over to the surplus side, enabling the Government to retire some of its maturing issues. More often the scale of demand for credit in the private sector of the economy had outrun the decrease in the Government's requirements so tha [illegible]

themselves selling their holdings on a falling market. Indeed, in the years since 1957 the Government has consistently operated at a deficit, thus adding to the pressure of demand for credit. As short-term security prices have fallen other institutions have been affected and the rise in interest rates has spread into medium-term and longer-term bonds.

67. When business is deteriorating, the demand for bank credit and competing forms of credit by the private sector of the economy tends to decline. If the federal government employs the counter-cyclical device of deficit financing, it may call upon the banks, directly or indirectly, to take up sizeable new issues of securities. The central bank may enable this to be done by providing the banks with sufficient reserves to support large-scale buying. Easy monetary conditions imply relatively low rates of interest, so that the banks have often found themselves buying bonds at high prices (low yields), knowing that later on they might have to sell at low prices (high yields) -- in order to accommodate their customers when conditions changed and money became tight. The only way out of this dilemma has been to hold a substantial volume of securities which mature within a short time. Of course this means sacrificing yield for liquidity. Experience since the mid-fifties shows that the banks have learned that, given massive government counter-cyclical fiscal policies and widely varying monetary conditions, their investment portfolios must be shorter than was the case formerly, and that

thought has to be given to anticipating changes in business conditions.

68. The effect of the cycle on the banks has been aggravated in recent years by the market reactions of other financial institutions, corporations, and the general public. In attempting to foresee changes in monetary and fiscal policies, both lenders and borrowers try to act in advance of the event. Hence interest rates may start rising long before a business recovery gets under way, and even in the face of continued monetary ease. Expectations of this sort have been significant in recent years, in the U.S. as well as Canada, and have helped to contribute to confusion as to the proper course to be followed by the monetary authorities.

69. Both domestic and external forces can create circumstances in which bond prices decline sharply. A notable example of such internal conditions occurred during the summer of 1959 when the pressure created by substantial sales of securities in a market where buying interest was nominal forced prices of short-term securities sharply downwards until yields were considerably in excess of 6%. For example, on August 13th the average cost to the Government of Canada of borrowing by way of three-month Treasury bills was 6.16%, and on September 14, 1959, the cost of borrowing in the form of 1-year bonds was about 6.80% and of 3-year bonds 6.52%. The Government of Canada, as the prime credit risk, is generally able to borrow at the lowest cost for any specific term. The cost of money to any other borrower should have exceeded these rates,

and while this was true of borrowings in the market place, the banks were faced with lending at not more than 6%, because of the limitations of the Bank Act. As a result, borrowers who might normally have been expected to have recourse to the market sought increased accommodation at lower rates from the banks, thus placing a further strain on bank resources. The substantial amounts normally borrowed outside the banking system were sought from the banks in competition with the normal demand for loans arising in the business sector.

70. Even partial fulfilment by the banks of abnormal demands is difficult and expensive when loanable funds have to be obtained by liquidating securities at low market prices. The procedure is much more expensive and the problem more acute than is suggested superficially by the selling of securities yielding more than 6% in order to invest in loans at not more than 6%. For example, in the easy money period of 1958 chartered banks participated in the Conversion Loan by acquiring large holdings of the new Conversion Loan issues of 3% due December 1, 1961, and 3-3/4% of September 1, 1965, both of which were entered on the books of the banks at or near 100.

	3% Dec. 1/61	3-3/4% Sept. 1/65
	$	$
Assume issues carried on banks' books at	100.00	100.00
If bonds sold on Aug. 26/59 Market price obtainable*	93.50	88.25
Loss on Sale	6.50	11.75

* Source: Bank of Canada Statistical Summary.

71. Thus, within one year after the purchase of these issues market prices had declined because of tight money conditions by $6.50 and $11.75 per $100 par value, or, in other words, by $650,000 and $1,175,000 per $10 million par value. Moreover if, when the bonds were sold, the proceeds were invested in loans at the maximum rate of 6% the loans would have had to be outstanding for extended periods before the increase in interest earnings would compensate for the substantial book losses, viz.: nearly 30 months to recover the loss on 3% bonds due December 1, 1961, and nearly 92 months to recover the loss on 3-3/4% due December 1, 1965. These calculations are based on the maximum lending rate of 6%, which would not be applicable to all customers, since the prime loan rate in fact never went above 4-3/4%. Moreover, no allowance has been made in the calculation for the real possibility that lending rates might decline, as in fact they did before the end of the period during which the loans would have had to remain outstanding.

72. Obviously, neither bank nor customer expected loans made in 1959 to remain outstanding for such

extended periods, so that the banks could not expect to recover the losses on securities sold. The banks were fully aware that they were taking substantial losses on securities, and also rapidly depleting their reserves of securities. At the same time, however, as the business upturn continued they were under pressure to continue making loans to their customers. In April of that year the prime loan rate reached 5.75% and there was no further possibility of rationing credit by price, that is, through interest rates. The banks then asked their large customers, especially those who were making use of non-bank sources of credit, to reconsider their requirements for bank funds, and some of the large lines of credit were reduced by agreement. Throughout this period however the banks made a deliberate effort to continue to meet on a normal basis the requirement of small borrowers. In May 1959, the banks made a joint announcement that they would exercise the utmost care in the handling of their credit facilities in order to avoid any significant further increase in the over-all total of bank loans. Despite this announcement the demand for loans continued to rise sharply, to a considerable extent because the level of market interest rates had been pushed above the 6% ceiling on bank loans. Market influences therefore provided an incentive to seek accommodation through the banks for new money requirements, and to delay the reduction of bank loans by normal funding operations. The crisis of liquidity came to a head in the abortive Treasury bill tender of August 1959;

shortly thereafter the demand for bank loans began to recede.

73. How far can the process of selling securities go before a bank feels that its liquidity is at a minimum level? This depends on several factors, which are: (1) the extent of the rise in yields and the concurrent fall in prices, and hence the cost of liquidating securities; (2) the size of the unused portion of established lines of credit; (3) the size of the portfolio of securities, both absolutely and in relation to other banks, and the speed with which it is being reduced; (4) the views of the monetary authorities; (5) the ability and/or willingness of bank managements to change their lending policies; and (6) expectations regarding the above factors.

74. Experience of the two periods of extreme monetary tightness which occurred in the 1950's gives some indication of the minimum levels of Government portfolios considered essential by the banks in such circumstances. In late 1959, for example, with cash reserves at 8% and secondary reserves scraping the 7% minimum agreed levels, the banks held combined portfolios of Canada's aggregating less than 15% of Canadian dollar deposit liabilities. Hence it is clear that the Government securities portfolio is reducible only within limits, beyond which the banks regard it is essential to the general safety of deposits.

Government of Canada Bond Portfolios

75. The general policy considerations relating to the size and character of the chartered banks'

portfolios of Government of Canada bonds have already been set out. The facts regarding these portfolios may now be summarized briefly.

76. In 1954-55, credit extended by the banks in the form of Canadian loans, mortgages and non-federal government securities amounted to about 52% of Canadian dollar deposits. By 1960-61 such accommodation had increased to 65% of deposits. This percentage is the highest since the nineteen-twenties, and it has been maintained for some two years. There has thus been an upward shift in the proportion of loans to deposits, and a corresponding downward adjustment in the level of security holdings which the banks have been prepared to accept.

77. The introduction of N.H.A. mortgages in 1954 and the secondary reserve agreement which came into effect in 1956 of course had important effects on the investment portfolios of the banks. From 1954 to 1961 N.H.A. mortgages grew to about 7% of Canadian deposits. Holdings of Treasury bills were increased from 3.2% in March 1954 to roughly 8% - 9% in 1961. In addition, the banks at the latter date held about 1% of deposits in the form of day-to-day loans. Government securities, other than Treasury bills, which constituted roughly 29% of deposits in 1954, were only 18% of deposits in 1961.

78. A classification of Government of Canada bond holdings seems to suggest that the increased requirements for Treasury bills have not produced any lasting decrease in holdings of bonds maturing within 2 years,

which are required for liquidity purposes. (It should be pointed out that it is not the 15% liquidity requirement which provides real liquidity to the banks, but only the excess of secondary reserves above 15%, plus the holdings of short-term Canada's.) The ratio of under-two-year holdings to Canadian dollar deposits was 7.0% in March 1955 and 7.7% in December 1961. In the interval, there were periods when bank holdings of "shorts" went down to figures as low as 3 - 4% of deposits, in the tight money squeezes of 1956, 1957 and especially 1959. On each of these occasions, the banks "ran off" or sold their shortest maturities, but their sales of medium and long bonds were less because of the large irrecoverable losses which would have been incurred.

79. The Conversion Loan in 1958 induced some lengthening of portfolios, especially in the over-ten-year category. But the banks shortened up again in late 1958, and have subsequently reduced their percentage of over-ten-year holdings. The percentage of Government of Canada bonds in medium-term maturities (5 - 10 years) has declined significantly, as has the average maturity of bank holdings.

The Non-Federal Portfolio

80. Bank holdings of "non-Federal securities", i.e., provincial, municipal, and corporate securities, are discussed below. Holdings of such securities are small relative to holdings of Canada's, and they do not perform the same function as do the securities of the federal government. That is, they are not related

directly to the problem of maintaining short-term liquidity against fluctuations in loans and deposits, primarily because they do not enjoy as broad and active a market as do federal obligations.

81. On the other hand, holdings of provincial and municipal bonds are by no means divorced from liquidity considerations altogether. The banks tend to buy short-term and medium-term provincial bonds, rather than long-term issues. Their municipal holdings are confined very largely to serial issues maturing within five or ten years, partly because this suits the asset structure of a commercial bank, and also because it helps to facilitate the repayment of debt by the municipality over a full 20-year period, with longer-term investors subscribing for longer maturities as a rule.

82. The banks buy provincial and municipal securities to obtain good yields combined with an early return of capital, and to assist in the underwriting and marketing of such issues.

83. Corporate securities are also held in bank portfolios in part to accommodate borrowing customers. They are sometimes acquired in relatively large blocks, and are frequently hard to distinguish from term loans except in form. During periods of easy money, such as in 1955, banks have been substantial buyers of corporate bond issues, but in recent years holdings of such bonds have been gradually running off without being fully replaced.

84. The banks do not purchase equities to any

great extent, largely because they are foreign to the main purpose and nature of a commercial bank.

85. The amount of provincial and municipal securities held by the chartered banks has been rising gradually in recent years but has not grown as rapidly as total bank assets. At present holdings of these securities amount to about 4% of Canadian dollar deposits. It might be noted that fluctuations in bank holdings of municipal debentures from year to year have tended to be in a somewhat narrower range than the variations in holdings of provincial bonds; the principal reason is probably the continuing supply of municipal offerings by way of short-term serial issues.

86. Bank holdings of provincial and municipal obligations while continuing to be substantial, have been declining as a percentage of the total outstanding debts of these two levels of government. Among the reasons for this decline are the relatively rapid growth in provincial and municipal debt and the lengthening of the terms for which provinces and municipalities borrow, and the recourse of provinces to other sources of funds.

87. The pressure on bank resources has tended to limit bank buying of provincial and municipal securities during periods of tight money in particular. During periods of easy money, the current flow of such securities has been sufficient to replace maturing holdings, but not sufficient to raise the percentage of assets held in this form to any appreciable extent. In addition, the banks have found it possible, during periods

of tight money, to dispose of some short provincial issues which had low coupons and which therefore appealed to certain taxable individuals and corporations.

88. Another factor is that the provinces and their important agencies, such as the Hydro authorities, have tended to borrow for longer terms than the banks find appropriate to chartered bank investment objectives. This in turn reflects the nature of their capital works, which have been increasingly long-term in character, i.e., schools, hospitals, sewer plants, hydro installations, and so forth.

89. Banks may purchase corporate securities either through the market as a profitable outlet for surplus funds or directly from borrowers at the time of issue as an accommodation for their customers. The latter type of purchase is related to the granting of term loans which is discussed in Section III. Whether a particular borrower should be urged to go to the market or not will be influenced to some extent by whatever is the current policy regarding term loans. It will also be influenced by other factors, including the receptivity of the market itself, the nature of the customer's requirements, and also the important matter of a proper balance between floating and funded debt in the corporate structure.

90. In the past few years chartered bank holdings of corporate securities have fluctuated between $450 million and $550 million and are currently about 3.5% of deposits. These holdings expanded considerably during the easy-money period of 1954-1955 when the

capital investment boom was getting under way, but have shown a continuing slow decline since then.

91. During the tight money conditions which prevailed in varying degrees for most of 1959, the corporate securities holdings of the chartered banks declined $40 million, or 7.2%, which probably represents the amount of maturities. This points to the principal disadvantage inherent in this type of investment, that is, the lack of marketability. On the other hand, the continuing decline in corporate securities during the comparatively easy money conditions of 1961 indicates that the banks have not resumed their participation during this latter period, partly because business demands for capital funds have been relatively modest.

SECTION III

LENDING

General Credit Policy

92. Traditionally, the chartered banks have been the primary source of short-term business working capital. Since the war the Canadian economy has grown rapidly and in this climate the banks have been expanding their facilities and broadening and developing both deposit and lending services. Changes in bank lending policies have been encouraged by the new opportunities of the postwar economy, by the introduction of new types of Government-guaranteed loans for special purposes, by the example of developments in banking in other countries, especially the United States and the United Kingdom, and by very active competition among the chartered banks themselves. The result is that although the main emphasis is still on short-term commercial loans, the banks are now accustomed to make loans for a much wider variety of purposes than they were in 1935.

93. Bank lending policy is formulated by the management of each bank, taking into account market conditions, general economic trends, and changes in monetary policy. Lending policy may be revised, for example, if weakness appears to be developing in a particular industry. The banks may try to discourage their customers from overexpansion in that line. Policy changes of this kind reflect the continuous assessment of credit risks which is a part of the

ordinary process of banking. In addition, however, as the business cycle moves from one stage to another, changes in official monetary policy will produce corresponding changes in the lending policy of the chartered banks. If this latter process is to work smoothly it is necessary that official policies be adequately signalled and clearly understood.

94. In administering credit policy it is usual to establish lines of credit for major customers who have a continuing need for accommodation. A line of credit is a stated amount within which a bank has indicated its willingness to accommodate a customer for a stated period of time, subject to the customer's continued credit-worthiness and to the maintenance of any conditions which may have been agreed upon between the customer and the bank, and subject also to general monetary conditions. It is usual for all commercial borrowers to operate under lines of credit but in practice other customers may also arrange to borrow in this way.

95. The line is commonly reviewed once a year, at the time that the customer's balance sheet becomes available, and he is able to project his financial position a year ahead. However, it may be reviewed at other times if the customer gets into difficulties or if there is a credit crisis, as in the summer of 1959. The line of credit lets the customer know how much credit he may normally expect in his operations, and authorizes the branch manager to make loans to the customer up to the agreed amount as long as there is no

adverse change in circumstances.

96. Banks view their lines of credit with a real sense of responsibility. As long as a line of credit is outstanding the bank's management regards itself as committed to making loans within the stated limit, subject to maintenance of the credit-worthiness of the borrower and subject also to the general availability of loanable funds. Credit stringency may on occasion require the reduction or adjustment of credit lines, which may impose some hardship on the borrower; however, normally a full discussion is held with the borrower before such actions are taken. Even in the credit crisis of 1959 the banks continued to provide funds under lines of credit in conditions of extreme difficulty and when the cost, in terms of losses on securities sold to provide available loan funds, was very great.

97. Bank lending policy is applied by issuing instructions to credit supervisors at the head office, to the various regional offices and to branch managers across the country, who are expected to follow them closely in making the loans which fall within their discretion. In this connection it may be noted that the period since 1955 has been the first for a generation in which the branch system has had to adjust to a changing monetary policy. Moreover, on occasion the somewhat obscure nature of monetary policies has made it difficult for head offices to determine and communicate appropriate policies to branch managers. Once a given policy is established, there is a natural reluctance to introduce changes in lending policy until

conditions have changed to such an extent that a modification is clearly indicated.

98. There are other practical problems which arise in adjusting lending policies to changing economic conditions:

(i) The banks may not be sure that a significant change is required until it is late in the business cycle. This is partly a matter of assessing business conditions correctly, of interpreting the policy of the monetary authorities properly, and of allowing for the leads and lags which frequently occur in the behaviour of demand for bank loans. Generally, bank loans are thought to lag behind a business recovery, but this was not the case in 1955-56. Again, bank loans may rise because business is deteriorating rather than improving, or they may rise as business acquires larger inventories ahead of a real improvement in business. When reviewing individual accounts it is often difficult to interpret from loan changes what the underlying changes in business have been. A further complexity is the problem of sorting out seasonal from other influences.

(ii) Adjustments in bank lending policies, apart from interest-rate changes, take effect primarily through alterations in lines of credit, and thus take some time to have their full effect. A changed policy can be applied at once to applications for new or increased lines

of credit, but it is not possible to review all existing credit lines and loan commitments at once. Indeed, the head office of a bank may not even know what its aggregate loans are doing until eight days after the event, i.e., until the make-up of figures for the preceding Wednesday week. It is extremely difficult for banks to anticipate the take-up of unused lines of credit.

(iii) In addition to the above factors, there is the natural tendency of commercial bankers to make good loans whenever possible. The training of branch managers is aimed at the development of officers who can seek out lending opportunities and make good loans. The manager's recognition and advancement depend to a significant degree on his abilities in making loans. He therefore finds it difficult to accept a policy of refusing loans or cutting back the existing lines of credit-worthy customers.

99. It should be remembered that the Canadian branch banking system has an important degree of built-in flexibility, because behind each branch stand the resources of a large nation-wide institution. The branch is not limited to its own resources, and subject to the general availability of funds,each borrower may be dealt with on his own merits without regard to the position of the branch.

100. The sharp fluctuations in monetary policy have in many cases encouraged customers to protect

themselves against possible restrictions by asking for a line of credit higher than their normal needs. The introduction of stand-by charges has often been suggested as a way of bringing lines of credit down closer to actual borrowings. Stand-by charges would probably have the advantage of discouraging customers from asking for unreasonably large lines of credit, and thus make it easier for the banks to predict the trend of their loans and so manage their resources more efficiently. Stand-by charges would also be likely to discourage large customers from using the banks as "umbrellas", i.e. establishing big lines of credit but using them only when they cannot borrow more cheaply elsewhere.

101. On the other side, however, there are a number of reasons why the banks are reluctant to impose stand-by charges on all lines of credit. As long as the line does not have a contractual status the bank knows that it can protect itself by reconsidering credit facilities if necessary; if a fee were exacted the bank might, in the absence of protective provisions, be legally committed even if circumstances changed drastically. Normally there are wide fluctuations in each loan account over the period of a year. For example, a customer may buy inventory and require working capital to finance it, then when he sells the inventory he may still need funds to finance his receivables. Finally, the loan is paid off. Such fluctuation in an account is a healthy sign. If the customer had to pay a stand-by charge he might borrow the full amount and try to employ the funds somehow even when he didn't

need them in his operations. This would make it difficult for the bank to have a proper understanding of his position and, more important, would deprive the banks of one of the big factors in their flexibility. At present loans in different industries follow different seasonal patterns, so that loans to merchandisers, for instance, are at their peaks at a different time from loans to the construction industry. The banks can count on this pattern, so that there is a continuous ebb and flow of loan demand, and it never happens that all lines of credit are drawn down to their maximum amounts at the same time. If all borrowers always borrowed their total line of credit the banks would have much less flexibility in their operations and much less freedom to manoeuvre, to take on new customers or take advantage of opportunities in lending or investment as they arose.

Credit Allocation

102. The maximum rate of interest which banks could charge on their loans was 7% until 1944, when it was lowered to 6%. At that time the general structure of interest rates was low and the ceiling had little if any significance. From 1944 to April 1956 the prime loan rate of the chartered banks was 4.50%, but it rose gradually to 5.75% by August 1957 and has varied only between 5.25% and 5.75% ever since then. This means that the banks are no longer able to use an increase in lending rates to moderate pressures on lending resources. It also means that the differential between yields on accounts involving varying risks or varying

service requirements is almost eliminated. The ceiling forces bank lending rates into a rigid pattern in which almost all borrowers pay much the same rate. Without the ceiling a flexible range of rates would be substituted for the present fixed level.

103. When credit is scarce and the banks are unable to raise lending rates further, they do not usually establish special restrictive policies regarding loans to particular industries, and never do so in respect of loans in particular regions. Certain types of loans are usually curtailed as less essential, such as term loans for projects which could be financed outside the banks, loans to buy securities or real estate for speculative purposes. Loans to other credit-granting institutions are also restricted when money is tight. In the main, however, the process of rationing credit involves reviewing each individual loan account on the score of the borrower's need for the funds, his possible alternative source of funds, the collateral advantage to the bank from the account, and any competitive factors which may be involved. It cannot be emphasized too strongly that having to implement a tight-money policy by placing restrictions on individual borrowers, having to choose among equally creditworthy customers and having in effect to decide which projects may go forward and which may be stopped by lack of funds, is a difficult and disagreeable task, but one which in the boom phase of the economy sometimes becomes necessary in order to conform to current monetary policy.

104. In the first instance a bank will usually restrict borrowing which appears to be non-essential. When a customer's balance sheet is examined it may appear that the line of credit which has been asked for is high relative to the size of the business. This may be because the borrower is trying to protect himself against tight-money conditions which he fears may arise in the future, or the customer may want a larger line of credit for prestige reasons, or the customer may be carrying inventories which are too large relative to sales, either because he is inefficient or because he is speculating on his inventory. In such cases the bank will probably tell the customer it considers that he is asking for more money than he needs.

105. Credit is not rationed on the basis of size of account. The banks have always assumed that their primary responsibility was towards their smaller business customers. The subject of loans to small borrowers has been reviewed with the Bank of Canada on various occasions since 1955 when the first tight-money period began. The withdrawal of the banks from the term loan field of lending did not apply in the area of small business and every effort has been made to meet the needs of those borrowers whose size does not enable them to obtain funds by issuing securities or other means.

106. The banks have recently carried out four surveys of outstanding loan accounts classified both by industry and by size. The most recent survey, at September 1961, gives an analysis of loans totalling

$5,830 millions. A few categories of loans were not included in the analysis. These were loans to provincial and municipal governments, to investment dealers and brokers and to grain dealers and exporters. Of this amount 32% was in accounts of under $10,000, and 52% was in accounts of under $100,000. Classified by number, 96.6% of all borrowers were in the under $10,000 category and only 0.54% had accounts of $100,000 or more. The proportion of total loans made available to smaller borrowers has risen slightly with each survey.

107. It must be realized, however, that in times of extreme credit stringency the banks will be obliged to curtail loans for the purpose of carrying securities or for speculative purposes and small borrowers in these categories will be affected in the same way as the larger ones, the prime objective being that of conserving lending resources for basic needs.

108. Direct controls on bank lending have not been used very much in Canada. During the war, however, the general restrictions imposed on consumer loans were applied to bank borrowers as well as to those who borrowed from other institutional lenders. These restrictions were not a part of ordinary monetary policy but were imposed by the Government under its wartime emergency powers. Consumer credit regulations were introduced again at the time of the Korean War. In addition, by agreement with the Bank of Canada in 1951 the chartered banks held a ceiling on their total loans for a year, and undertook specifically not to add to their loans to instalment finance companies or to loans

for capital purposes.

109. Since 1952, (apart from the secondary reserves agreement of 1955, which restricts the proportion of bank assets available for loans,) the only direct controls on particular borrowers have been those on term loans and on loans to instalment finance companies. At the suggestion of the Bank of Canada the banks have curtailed these two types of loan from time to time, especially in periods of tight money. When credit has been scarce term loans have been cut back on the ground that if the borrowing is necessary it can and should be carried out in the capital market. Similarly under conditions of credit stringency loans to instalment finance companies have been limited partly because of the central bank's desire to discourage the use of consumer credit, and partly because the finance companies themselves have access to the money market. Furthermore, when lending in general has to be restricted, it is only fair and proper that the access of instalment finance companies to bank credit, for relending to the general public, should also be curtailed along with the loans the banks make directly to the general public.

110. Despite these considerations, however, the banks are not in favour of direct controls on loans to finance companies whether imposed by the central bank or the Government. If one group of institutions is to be restricted in this way it would be only logical to apply controls to all other financial institutions, and the banks are not in favour of a widespread system of

controls. Moreover, a small finance company, like any other small business, is much more dependent on its banks for funds than is a large company. If bank loans to the small finance companies were curtailed they would have great difficulty in finding alternative sources of funds. This example illustrates the problems which arise in attempting to apply selective controls on bank lending. Similar problems would arise in attempting to enforce special credit policies towards particular industries or regions.

111. We believe that any form of selective controls on bank lending would reduce the flexibility of the Canadian banking system which has been one of the strongest factors in the growth of the economy. The responsible authorities, with the best intentions, may try to channel credit into specific areas. But in a growing and developing economy conditions, markets and industries change rapidly. How much credit is needed in each sector at any given time is a matter of judgment, and the banks' view is that the question is more safely left to the combined judgment of the banking system and other financial institutions, based on competitive market forces and carried out in co-operation with general Government and central bank policies than to any arbitrary system of controls.

Loans under Sections 82, 86 and 88

112. One of the most distinctive features of bank lending in Canada, which is not a postwar development but goes right back to the 19th Century, is the legislation which allows a chartered bank to make advances

on the security of natural products and goods, wares, and merchandise while they remain in the borrower's possession. This is Section 88 of the Bank Act. Similarly, Section 86 of the Act provides that a bank may lend on the security of warehouse receipts, bills of lading, etc., and Section 82 makes provision for banks to make advances to oil operators on the security of hydrocarbons in, under, or upon the ground. All these sections were designed to encourage the development of Canadian resources by enabling producers, wholesalers, and manufacturers to borrow more than they otherwise could to meet the essential financial needs of their business pursuits. Parliamentary records show that the same motive was behind subsequent steps in the development of this feature in the banking system. These sections of the Bank Act are a means of providing support in many fields of endeavour to an extent which otherwise would not be practical from the standpoint of prudent banking. This applies particularly to what may be termed smaller business enterprises with limited financial resources, and often to business enterprises at an early stage in their development, before they have sufficient resources to qualify them for bank credit in the ordinary way.

113. In addition to small businesses, individuals and farmers there are a substantial number of well-established middle-sized businesses in Canada engaged in manufacturing or processing raw materials which must depend on inventory to support or secure borrowings for operating purposes. These firms require bank advances

for the purpose of meeting wages, accounts payable to suppliers, overhead, and other expenses in the ordinary course of business. Section 88 enables such firms to use their inventory as security for bank loans, and it is through assistance in this manner that raw materials end up as finished products for sale in the domestic or foreign market.

114. One example that could be given as an illustration is that of a manufacturer with only a modest working capital but with a reasonable investment in fixed assets. He has an inventory valued at $150,000 and accounts receivable totalling $100,000 and he wishes a bank credit of say $125,000. It would be usual to advance a percentage of receivables, which we will say in this case is 75%, equalling $75,000. Security would be taken under Section 88 against inventory and this would provide the basis to increase the loan to $125,000, thus meeting the customer's requirement. Without the provisions of Section 88 it would likely not be possible to give this manufacturer the support he requires, which could make it difficult, or even impossible, for him to continue a normal operation. This example is simply to illustrate that financing of receivables would not always suffice, and security against inventory supplies the means to provide the additional funds required in his operation. At this stage in the development of the Canadian economy there are still many business concerns of this kind, so that Section 88 of the Bank Act is a fundamental link in the chain of financing economic activity in this country.

115. A classification of loans outstanding in mid-November 1961 for which security had been taken under Sections 88, 86 and 82 is summarized here. The statistics cannot be analyzed too precisely because in many cases more than one type of security is involved in the loan account.

	Number of Borrowers	Authorized Credits	Amount of Advances
		$'000	$'000
Under Section 88	33,180	1,554,990.	924,895.
Under Section 86	345	250,029.	85,999.
Under Section 82	114	73,672.	48,929.
	33,639	1,878,691.	1,059,823.

Agriculture is one of the most important areas to which these sections apply. About 27,000 of the 34,000 borrowers classified at November were farmers, and in addition most Farm Improvement Loans are supported by security provided under Section 88. Advances may be made for the purchase of seed grain, seed potatoes or fertilizer, secured by the crop to be grown. Loans may also be made on the security of livestock, thus assisting farmers to diversify their operations, and on agricultural implements, thus encouraging greater efficiency of production. The financing of grain inventories held in country elevators has also been facilitated by means of these sections. Canning and fish processing have been assisted substantially. The forest products industry and the mining products industry are large areas

to which Section 88 applies. In manufacturing many small and new businesses have received bank support through Sections 86 and 88 which they could not otherwise have had. Those types of business which show a sharp seasonal movement have found this kind of bank accommodation particularly helpful. Sometimes inventory is manufactured in one season to cover sales for a whole year, as in the canning industry. Or inventory may be built up all year for one concentrated sales period, as in the case of the manufacture of toys. Assistance is often required to finance the accumulation of this inventory to meet future delivery dates, with Section 88 providing the basis.

116. Altogether the sample figures show that in November loans outstanding under these Sections of the Bank Act were just over $1 billion, which would be about 18% of total general loans outstanding at that time. Although, because of the fact that there is often more than one type of security behind a given loan account, it is impossible to say what proportion of the loans could not have been made without the use of Sections 88, 86, and 82 of the Bank Act, it is likely that most of these borrowers would not have been able to borrow, or would have borrowed at higher rates from other institutional lenders. In many cases the rates charged by other lenders for loans on basic materials would have been so high that the business could not have been undertaken profitably.

117. In the absence of the provisions of Section 88 of the Bank Act, the banks could acquire security

over the inventories of corporate borrowers through the medium of collateral debentures as provided for in s. 75(5) of the Bank Act providing a floating charge over inventories as well as all other current assets. In many cases however such a procedure would be impractical. In any case it would be costly to the borrower and it would not be available to individuals or partnerships, who constitute a very large proportion of Section 88 borrowers particularly in the field of agriculture.

118. In summary, we believe it would be difficult to exaggerate the importance of the availability of Section 88 security to borrowers as a means of financing a very significant part of Canadian production.

Term Loans

119. As a general principle large business corporations should expect to rely on the chartered banks primarily in respect of short-term working capital needs and should finance their longer-term capital requirements by selling securities in the market. Some longer-term borrowers may, however, be accommodated by the chartered banks through term loans, particularly smaller firms whose requirements for funds are relatively modest and for whom the costs of a market issue, in terms both of interest and of underwriting cost, would be disproportionately high.

120. Following a period of loan expansion which started in the middle of 1954, the Bank of Canada suggested in November 1955 that it would be desirable for chartered banks to refrain from making commitments for

term loans. It was pointed out by the Bank of Canada that the proposed restrictions need not apply to housing loans, loans to provinces and municipalities, farmers and other individuals. The banks agreed on November 30, 1955, that they would refrain from making term loans (then defined as loans that would be outstanding for more than a year) for amounts in excess of $250,000. Subsequent experience showed that there was need for greater flexibility, and it was agreed that the general objective would be served by a limit which would permit small businesses to obtain greater term accommodation. The limit has been changed from time to time, and is currently $1 million. Though the definition has also been changed, term loans are currently considered to be loans in respect of which repayment is scheduled in more than two years from the date of the initial advance, even though subject to annual review. At the end of 1961 total chartered bank loans outstanding under authorized credits of $1 million and over amounted to about $1.5 billions, and of these about $50 millions were classified as term loans. In addition, bank holdings of corporate securities totalled $470 millions, though some of these would have been market purchases.

Personal Loans

121. The banks have always made loans to individuals for a great variety of purposes and with a great variety of repayment arrangements, within ordinary banking practice. Some of these loans were very similar to the instalment loans now being made.

In the 1930's, however, there was a good deal of public criticism of the rates charged for small loans by some lenders, and this led ultimately to the first Small Loans Act, passed in 1939. Against this background one of the chartered banks began in 1936 to offer a special kind of personal loan which may be called an instalment credit loan. Full details of this plan were presented to the Banking and Commerce Committee in 1944 and 1954. During the past few years most of the other banks have also set up instalment credit loan plans, a development facilitated by the 1954 revision of the Bank Act which allowed the banks to take chattel mortgages as security. This development was also encouraged by the fact that banks in the United States had been successful in the consumer credit field for a number of years and that banks in the United Kingdom also entered the field on a large scale in 1958. In general, the banks have set up these programs to reach a group of borrowers who, while unable to provide collateral in the traditional form, are nevertheless creditworthy, and who wish to borrow for worthwhile purposes usually connected with their homes and families. We believe that consumer instalment credit has become firmly established and that such loans are a logical development of banking services. The extensive branch bank system is highly suitable for providing consumer credit. Because the banks already have well developed facilities they are able to offer consumer credit at rates which (including service charges) are more favourable to the borrower than those charged by specialized institutions. The

banks are also well aware that a customer who comes into a branch initially for an instalment credit loan is likely to want to make use of the other services offered by the bank, so that these loans attract other business.

122. The most important category of instalment credit loans is loans for the purchase of automobiles, but large numbers of loans are also made to finance the purchase of furniture, to pay medical bills or holiday expenses, and to consolidate debts. The main characteristic of such loans is that they are intended to be repaid out of future income of the borrower and are usually repaid in equal monthly instalments on an amortized basis. They are usually made for an overall term of not more than 36 months, and not usually for an amount of more than $5,000. A normal feature is insurance to repay the balance of the loan in case of the death of the borrower.

123. Although instalment credit loans of the chartered banks are not shown separately in bank loan statistics, total personal loans in the group which includes loans made under these programs (that is total personal loans excluding those fully secured by marketable bonds or stocks and Home Improvement Loans guaranteed by the Government) stood at $1,029 million at the end of December, 1961, compared to about $350 millions at December, 1954. Of course instalment credit granted by other lenders has also been rising in this period. It is estimated, however, that the chartered banks' share of consumer credit has risen from about

21% to 32% since 1954.

Mortgage Lending

124. Legally, Canadian chartered banks were not allowed to take mortgage security except as subsequent security, but in 1954 a major change in the Bank Act was introduced which enabled the banks to acquire mortgages securing loans under the National Housing Act. From 1954 to the end of 1959 the banks approved N.H.A. mortgages to a total of $1.3 billions, accounting for about 35% of all N.H.A. loans made in this period. By the end of 1959 N.H.A. mortgages were about 6% of total chartered bank assets. In 1959 monetary conditions were such that the banks' lending resources were under heavy pressure and the rate of mortgage loan approvals declined sharply. In December 1959 the maximum N.H.A. rate permitted was raised by the Government to 6-3/4%, and although banks could still process N.H.A. mortgages, counsel's opinion was that they could not do so at a higher rate than 6% because of the legal ceiling on bank lending rates. The result was virtual cessation of N.H.A. lending by the banks, since if they had made mortgage money available at 6% while all other lenders were charging 6-3/4% the banks would have been faced with very large demands for funds and an impossible task of credit rationing. It is however permissible to invest in N.H.A. mortgages initiated by other lenders, and in recent months the banks have acquired small amounts of mortgages which have been sold at tender by Central Mortgage and Housing Corporation.

125. Although the banks were somewhat reluctant to

enter the mortgage field in the beginning, their experience in the field has been favourable. Now that they have built up efficient departments to initiate and service mortgage loans and have acquired such a substantial stake in the mortgage lending business (which is essentially a long-term operation) it is in the public interest that they should be allowed to participate in N.H.A. mortgage lending on a continuous basis at whatever may be the going rate of interest for such loans, even though there may be fluctuations in the supply of and demand for mortgage funds from year to year.

126. From time to time arguments have been advanced against the desirability of the banks being authorized to lend on mortgage security generally, and therefore against extending their powers so that they can hold conventional mortgages. For one it is said that the chartered banks are responsible to their depositors, who make up a very substantial proportion of the population of the country. The deposits of the chartered banks are repayable on demand or short notice and the banks must always be in a position to observe the terms on which funds are entrusted to them by depositors. Thus, liquidity is essential and long-term mortgages are not a liquid security at present and a secondary market is only slowly developing. Since the problems of the nineteen-thirties were great and numerous it is also suggested that one reason for the avoidance of a banking crisis in Canada was the fact that the chartered banks did not have deposit funds

invested in long-term loans on real estate. While the banks do now have such investments in the form of N.H.A. mortgages, these mortgages carry a Government guarantee supported by an insurance funds, so that any real estate acquired after foreclosure or otherwise is quickly converted into cash. Another argument is that granting conventional mortgages on various types of properties is a specialized field and many problems of valuation, terms of repayment, titles, etc. arise. It is said therefore that it would be difficult to set up the necessary lengthy and complex instructions for a widespread branch system. Finally it is said that historically the chartered banks have not entered into this field and specialized institutions have developed for the purpose.

127. The possibility that enabling the banks to engage in mortgage lending would undermine their ability to serve their depositors and to fulfill their functions as commercial banks is considered to be without foundation. The history of banking shows that a portion of a bank's deposit funds may, subject to proper safeguards, be made available for long-term investment. The developing success of most other institutions that compete with the banks for savings deposits can be traced to their freedom to employ a portion of such funds in housing loans and other longer-term investments. In other countries these are recognized as perfectly normal and appropriate outlets for a portion of the deposits held by savings banks and other institutions and, in Canada, savings depositors are

showing an increasing preference for the sort of savings institution that is permitted to invest in conventional mortgage loans.

128. The present-day practice of requiring regular amortization of mortgage contracts greatly reduces the risk of losses compared to the experience of the 1930's when such provisions were not customary. It now is generally accepted that the fact that United States banks held mortgages on real estate was only one of many factors which contributed to the banking crisis in that country and was by no means a decisive factor in their difficulties. The fact that banks in the United States again are engaged in conventional mortgage lending as one of their major services lends support to this observation.

129. Conventional mortgage lending would further broaden the services which the chartered banks render their customers and would help to ensure a sufficient supply of mortgage funds from private sources. Estimates of housing requirements for the years ahead indicate the banks could render useful service if granted the same freedom as other lenders in the field. This should permit more public funds to be directed to special programs such as low rental housing, housing for elderly people, etc.

130. Existing Bank Act restrictions have the effect of shielding the conventional mortgage market from bank competition. Participation of the banks in the field should lead ultimately to a narrowing of the spread between typical mortgage rates and the return on savings

with beneficial results to the public. Other mortgage lending organizations collectively offer quite extensive competitive facilities in the larger centres but smaller cities and towns where the banks already are represented are not adequately served by institutional mortgage lenders.

131. The chartered banks have acquired substantial portfolios of N.H.A. mortgages. The mortgage procedures as laid down in the National Housing Act do not permit re-financing of mortgages either to increase the principal owing or for any other reason. When a property is sold by the owner, the purchaser normally assumes the existing mortgage and either pays all cash for the difference or part cash and gives back a second mortgage to the vendor. In the years ahead, as principal owing reduces on each mortgage, a purchaser is more likely to require a larger mortgage than the one then existing. Consequently it is more than possible that a new higher conventional mortgage will be obtained (say to 66-2/3% of the then appraised value) and the existing N.H.A. mortgage paid off in full. If banks cannot handle this re-financing by making a higher conventional mortgage loan, they could eventually find principal repayments being made in very substantial proportions, depleting existing portfolios quickly. If the chartered banks are able to make conventional mortgage loans, a means of reinvesting the repayment funds will be available and this would also enable the banks to render the vendors and purchasers a service by making it unnecessary for

them to seek accommodation elsewhere. Banks are permitted to assist customers in the purchase or construction of dwellings financed under N.H.A. and should also have facilities to assist those who for various reasons wish to do their financing by means of conventional mortgages.

132. As the Bank Act now stands it is possible for the chartered banks to buy bonds or debentures issued against mortgage security, which in effect amounts to a form of mortgage lending, and it is inconsistent to deny them the power to make direct mortgage loans.

133. More and more, as other legislation is created, for example, the Small Businesses Loans Act, the National Housing Act 1954, and the Farm Improvement Loans Act, special provision is required authorizing banks to take mortgage security for specific items in order to overcome the Bank Act restrictions. In the conduct of the banks' ordinary business too, there are many occasions where being able to take mortgage security as collateral would make the difference between granting or refusing to assist a customer and again there seems now to be no good and valid objection to granting to banks the widest powers in this direction. A typical situation of this sort might involve a medium-term loan to a smaller business readily available from its present bankers if they were not prohibited from taking mortgage security over real property. As matters stand the customer probably turns to the Industrial Development Bank only because the

Government bank is not confined by similar restrictions.

134. On balance we think the public interest would be best served if the banks were freed from the existing restriction in the Bank Act with respect to the taking of mortgage security, thus leaving the banks free to exercise their own discretion in this area of lending. As to safeguards in the public interest, the Canadian banking system has a proven record of the sort of judgments it brings to bear on loan policy throughout the country. Mortgage lending on a fully competitive basis would evolve in an orderly fashion, it would be carefully geared to the necessity for adequate liquidity, and the pace of the advance would be carefully measured.

135. In a related context the powers of the banks to take specific security in the course of lending operations appear to be unduly limited in the light of present day requirements. For example, the power of the banks to take chattel mortgage security is at present limited to loans made to an individual on the security of household property (as defined in the Bank Act), with the result that the banks are prohibited from taking such security either on a wider range of goods or in respect of manufacturers' and dealers' inventories. We recommend that the whole matter of existing limitations on the nature of specific security available to the banks should be thoroughly reviewed with a view to leaving the banks as free as possible to take such security as the requirements of individual situations might indicate. The result would, we

suggest, be an appreciable and useful broadening of the banks' ability to serve the increasingly complex and changing requirements of the business community.

Government Sponsored Lending Programs

136. Specific Acts of Parliament provide for bank loans to particular classes of borrowers on favourable terms. In each case the Government guarantees a percentage of the loans made by each chartered bank. Such loans make up about 4-1/2% of all general loans outstanding.

137. Farm improvement loans are granted under the Farm Improvement Loans Act and are guaranteed against loss up to an amount equal to 10% of the aggregate principal amount made by the individual bank during each lending period of approximately three years. At December 31, 1961, the amount outstanding under the Act was $194 millions. Throughout the period the rate that the chartered banks could charge for these loans was restricted to 5%. Until April 1956 this was above the prime rate which up to then was 4-1/2%. From August 1956 to the present, however, the prime rate was above 5% so that since then these loans have been available to farmers on especially favourable terms.

138. Prairie grain loans refer to special loans granted to western farmers under the Prairie Grain Producers Interim Financing Act of 1951 and of 1956 and under the Prairie Grain Loans Act of 1960. The first two acts were passed to assist farmers who were left with unthreshed grain in the fields by early falls of snow. There is no information readily available on the

amount of loans granted under the first interim financing act but under the second a total of 23,234 loans were granted amounting to a total of $19,424,890. Under the Prairie Grain Loans Act only 64 loans were granted for a total of $34,210.

139. Fisheries improvement loans are granted under the Fisheries Improvement Loans Act which came into effect in December 1955. From January 1st, 1956, to March 31st, 1961, 795 loans amounting to $932,421. were made under this Act by the banks. Over the same period other lenders have made a total of 59 loans amounting to $117,470. Hence, the chartered banks have been by far the most active lenders under the Act, although, as the figures indicate, the demand has not been large. These loans are guaranteed up to 15% of the aggregate principal amount of the first $500,000 lent by each bank, and 10% of the excess over $500,000.

140. Business improvement loans are granted under the Small Businesses Loans Act, which came into force on January 19, 1961. The purpose of the Act is to provide for intermediate and short-term credit, not exceeding $25,000. to the proprietors of manufacturing, wholesale trade, retail trade and service businesses having a gross annual revenue estimated not to exceed $250,000. for the improvement and modernization of equipment and premises as described in the Act. The bank is required to take security on the equipment or real or immovable property in respect of which the proceeds of the loan are to be expended, except where it is considered necessary or advisable to take other security. Loans

made by all banks from inception on January 19, 1961, to the end of December, 1961, numbered 2,977 for a total amount of $25,582,000. These loans are guaranteed by the Government against loss to the extent of 10% of the aggregate principal amount of loans made by each bank during the period ending December 31, 1963. In Quebec it is not possible to take security by way of chattel mortgage on movable equipment, the security primarily stipulated by regulation, and consequently loans for the purchase of such equipment have been limited to those cases where other acceptable security was obtainable.

141. Home improvement loans are granted under the National Housing Act for a very wide variety of home alterations and improvements. Losses are guaranteed under the National Housing Act up to 5% of the aggregate principal amount loaned by each bank. From the beginning of the program in 1955 to the end of 1961 206,767 loans were granted amounting to $237,982,000.

142. Veterans' loans were granted under the Veterans' Business and Professional Loans Act. Lending under the Act came into force in January 1947 and reached a peak of over $5 million in 1948. The amount outstanding since then has gradually declined to approximately $200,000.

143. Loans to the Canadian Wheat Board to finance grain deliveries differ substantially from the loans made to individuals for capital purposes under the above-mentioned Acts; they carry a Government guarantee. Similarly, loans made for the purchase of Canada

Savings Bonds are Government sponsored and free from risk. Adding these loan categories to guaranteed loans proper, their sum accounts for 8.3% of total loans in 1961, almost unchanged from 8.1% in 1954. However, if the substantial volume of insured N.H.A. mortgages granted by the banks is included an entirely different picture is given of the extent to which the banks are supporting Government-sponsored projects. On this basis almost 21% of the total of Canadian loans are now granted under a Government sponsored program. The introduction of insured mortgages raised this percentage from 8.1% in 1954 to its present high level. The recent introduction of business improvement loans will no doubt raise the percentage even higher.

Financing Exports and Imports

144. In the past few years international money markets have developed considerably and it has become steadily easier for exporters and importers in most parts of the world to choose to finance their transactions wherever interest rates are lowest. In the case of Canadian exporters and importers, once goods have left Canada or before they have entered this country, financing is sometimes arranged in London or New York. While the goods are in Canada the financing is usually done here and most of it is done by the chartered banks in the course of their normal business. The banker's functions in connection with foreign trade may be divided into two main sections. The first is the handling of foreign exchange; i.e. the banks provide the machinery by which the Canadian importer pays

the foreign seller of the goods or the Canadian exporter receives payment for the goods he is sending abroad. The second main function is in facilitating the credit arrangements between buyer and seller, including the furnishing of credit reports, and the extension of bank credit or other means of financing the transaction.

145. The settlement of Canada's foreign trade transactions is usually handled through one of three principal methods:

1. Payment through open account
2. The use of Bills of Exchange
3. The use of Commercial Letters of Credit.

Where buyers and sellers have an inter-company relationship or are otherwise well and favourably known to each other, and where there are no serious exchange transfer difficulties, exports are often arranged on an open account basis. By this method the cost of goods exported is charged to the foreign importer's account on the books of the Canadian exporter, and settlement between them is made on the basis of private arrangements. The transactions are known as "clean payments", and a large volume of these payments is handled daily by Canadian banks on instructions from correspondent banks around the world.

146. A large and growing proportion of Canadian export trade is financed by means of sight or time drafts drawn on the foreign buyer. The export may be financed by discounting the relative bill of exchange with one of the chartered banks at the time of shipment.

Alternatively, the bill is often left with the bank for collection through a foreign correspondent. Still another financing procedure is for the Canadian exporter to pledge the bills to his bank as partial or full security for a general line of credit. In the latter case the bank will usually arrange for the collection of the bills and apply the proceeds against the exporter's loan.

147. On the import side the banks handle a large volume of bills of exchange drawn by foreign suppliers. The settlement of these items frequently requires short-term advances to the Canadian importer to bridge the time between his payment for the goods and his subsequent sale of the goods in Canada. A further portion of Canada's imports is financed through Commercial Letters of Credit issued by the chartered banks. These are issued in a wide variety of forms and their processing is a highly complex undertaking calling for specialized departments within the banks. The Canadian banks also act as agents for their correspondents abroad in the processing of foreign Letters of Credit covering Canadian exports.

148. The financing of Canadian external trade is not confined within the limits of actual export and import transactions but extends to cover the full period dating from domestic production operations to final settlement from foreign buyers, in the case of exports, and the time between the signing of a contract to purchase of foreign goods and their eventual disposal to the consuming public in Canada or elsewhere, in the case

of imports. Frequently the complete cycle will be financed under an ordinary line of credit.

149. Where the nature of foreign trade transactions requires longer-term financing, one to five years, the banks may go to the Export Finance Corporation of Canada Limited. Under the Export Credits Insurance Act, Section 21A, the Government makes available facilities for the financing of transactions which may not fall within the scope of the activities of the Corporation, as for example when credit terms are longer than five years. The Corporation was established by the banks in April 1961 to provide new medium-term financing facilities for the purpose of assisting Canadian exporters to meet the credit terms offered in world markets by foreign suppliers. The basic principles in handling business put through the Export Finance Corporation of Canada Limited are:

(i) Each transaction must be covered by Export Credits Insurance.

(ii) Credit terms are not to be longer than five years.

(iii) The exporter will arrange the required financing through his own bank which, in turn, will have access to the rediscount facilities of Export Finance Corporation of Canada Limited.

The operating procedure of having exporters go through their own bank with this type of financing reduces handling routine and costs to a minimum. In effect, the banks do the work and thereby make it possible for

the Corporation to function satisfactorily in modest quarters and with a small staff.

150. The Export Finance Corporation of Canada Limited is, in fact, a "rediscount bank" to which chartered banks turn over foreign trade obligations discounted by them for Canadian traders who have taken the bills in settlement for export sales. As the corporation progressively builds up its portfolio of bills, it will in turn raise funds against these assets by selling its own notes to the investing public. The underlying security for these note issues will be the Corporation's capital resources, the rediscounted trade paper with the obligation of the Canadian exporter and the foreign buyer, and any security the foreign buyer may have put up, as well as the protection of Export Credits Insurance. In addition, the trade paper will bear the "with recourse" endorsement of whatever chartered bank rediscounted it. With this underlying strength, the Corporation's issues will be a prime investment and it should be possible to acquire working funds through the investment market to an amount of several multiples of the Corporation's paid-up capital. The Corporation's rediscount rates must, of course, be determined by market conditions at the time of the respective transactions. In this connection, the broad operating objective is that all-in charges to the Canadian exporter should be on a scale that will enable him to compete effectively with the quotations of other international traders.

151. At the inception of the Corporation, it was

expected there would be a substantial demand for money to finance the export of manufactured capital goods but, thus far, the volume of this business has been disappointingly small. However, some of the export business undertaken since these new financing facilities became available will not yet have reached the stage where term trade paper in settlement for the sales has been received and is available for rediscount. At the end of 1961, there is something less than $65 million of rediscounts on the Corporation's books, a large part of which was either held by the banks prior to the setting up of the Corporation or relates to the export of commodities such as grain.

Bankers' Acceptances

152. In order to broaden and improve the facilities and operations of the money market in Canada the chartered banks have given very careful study to the creation of a market in bankers' acceptances. A detailed study of the techniques and procedures which relate to the bankers' acceptances market in both the United Kingdom and the United States led to the conclusion that neither system could, without considerable variation, readily be adapted to Canadian conditions. As a result bankers' acceptances in Canada will not follow either the New York or the London pattern. As far as possible bankers' acceptances will be drawn in connection with the financing of goods, wares and merchandise of a type described in Sections 18(1) (f) and (g) of the Bank of Canada Act, will be in larger denominations and will be of a self-liquidating nature.

It is as yet too early to determine the extent to which Canadian firms will find bankers' acceptances a convenient and suitable medium.

153. The money market dealers will act as principals to purchase and sell bankers' acceptances for their clients. The function of the chartered banks will be to assess the credit worthiness of the drawer of the acceptance draft and, if his is the primest credit, to accept such a draft and return it to the drawer. It is the drawer's responsibility to sell the accepted draft to a money market dealer. Bankers' acceptances will be eligible collateral as security for day-to-day loans in the money market and under Section 18 (1) (b) of the Bank of Canada Act the Bank of Canada has indicated its willingness to deal in bankers' acceptances which have a term to maturity of not more than 90 days. During the initial stages of the development of the acceptance market the chartered banks, in order to assess the usefulness of this new instrument in the market place outside the banking system will not themselves purchase acceptances for their own account. It has also been agreed that, after a period of six months from the beginning of the market in bankers' acceptances, the chartered banks will review the experience gained in that interval and make such changes in techniques and procedures as in the light of this experience are necessary or desirable.

TABLE I

STATISTICS RELATIVE TO SECTION 88 ADVANCES BY ALL BANKS IN CANADA

Excluding Farm Improvement Loans and Fisheries Improvement Loans

Classification		Number of Borrowers	Authorized Credits $'000	Outstanding Advances $'000
4 (1)(b)	AGRICULTURE (Farmers)	26,850	93,481	80,233
4 (2)	INDUSTRY			
(a)	Chemical and Rubber Products	151	37,815	20,027
(b)	Electrical apparatus and supplies	97	56,783	35,908
(c)	Food, beverages and tobacco	730	223,041	140,429
(d)	Forest Products	1,607	211,912	123,183
(e)	Furniture	245	19,339	14,175
(f)	Iron and Steel Products	576	131,683	78,947
(g)	Mining and Mine Products	269	68,134	40,303
(h)	Petroleum and Products	35	11,255	2,280
(i)	Textiles, leather and clothing	933	124,844	84,748
(j)	Transportation equipment	59	16,924	7,679
(k)	Other Products	403	36,765	25,789
4 (5)	GRAIN DEALERS AND EXPORTERS	170	364,991	173,516
4 (7)	MERCHANDISERS (Wholesalers)	764	146,308	88,448
4 (8)	OTHER BUSINESSES AND SERVICES	291	11,715	9,230
		33,180	1,554,990	924,895

Bank advances under the Farm Improvement Loans Act as at September 30th, 1961 totalled $199,300,000. and most of these loans would be supported by security provided under Section 88 of the Bank Act.

TABLE II

STATISTICS RELATIVE TO SECTION 86 ADVANCES BY ALL BANKS IN CANADA

Classification	Number of Borrowers	Authorized Credits $'000	Outstanding Advances $'000
4 (1) (b) AGRICULTURE (Farmers)	22	207	154
4 (2) INDUSTRY			
(a) Chemical and Rubber Products	1	105	105
(b) Electrical apparatus and supplies	4	,575	511
(c) Food, beverages and tobacco	55	36,202	21,900
(d) Forest Products	2	251	141
(e) Furniture	1	10	10
(f) Iron and Steel Products	6	1,186	1,056
(g) Mining and Mine Products	2	110	71
(h) Petroleum and Products			
(i) Textiles, leather and clothing	18	3,090	1,059
(j) Transportation equipment	3	137	39
(k) Other Products	3	61	57
4 (5) GRAIN DEALERS AND EXPORTERS	50	177,485	46,884
4 (7) MERCHANDISERS (Wholesalers)	161	22,114	13,256
4 (8) OTHER BUSINESSES AND SERVICES	17	8,496	756
	345	250,029	85,999

TABLE III

STATISTICS RELATIVE TO SECTION 82 ADVANCES BY ALL BANKS IN CANADA

Petroleum and Products	114	$73,672	$48,929

TABLE IV

GENERAL LOANS OF THE CHARTERED BANKS UNDER PROGRAMS SPONSORED BY THE GOVERNMENT OF CANADA, MARCH 31, 1954-61

(millions of dollars)

Types of Loans	1954	1955	1956	1957	1958	1959	1960	1961
Farm Improvement Loans	131.6	121.9	124.0	121.2	118.0	136.6	154.6	174.5
Prairie Grain Loans[1]	*	*	.8	.5	.9	.4	.1	*
Fisheries Improvement Loans	-	-	.1	.2	.2	.3	.3	.4
Business Improvement Loans	-	-	-	-	-	-	-	1.9
Home Improvement Loans	-	1.7	25.8	39.4	47.6	60.0	55.5	56.1
Veterans' Loans	2.0	1.7	1.4	1.0	.7	.5	.3	.2
Total General Loans Guaranteed	133.6	125.3	152.1	162.3	169.2	197.8	210.8	233.1
Total General Loans	3,047.5	3,087.2	3,945.2	4,056.4	4,023.2	4,311.8	4,713.7	5,052.8
Percentage of General Loans Guaranteed	4.4%	4.1%	3.9%	4.0%	4.2%	4.6%	4.5%	4.6%

[1] Loans made under the Prairie Grain Producers Interim Financing Act of 1951 and of 1956, and under the Prairie Grain Loans Act of 1960.

* Less than \$.05 million. - no loans made or outstanding.

SOURCES: Bank of Canada, Statistical Summary, July, 1961, and Financial Supplement 1958, and 1959; Department of Finance, Public Accounts of Canada, Vol. 1, Part 1, for the years 1954 to 1960, Report of Operations of the Veterans' Business and Professional Loans Act, 1954 and subsequent years, Report on Operations under the Fisheries Improvement Loans Act, 1957 and subsequent years, and other information supplied by the Department.

TABLE V

LOANS, MORTGAGES AND OTHER ADVANCES UNDER GOVERNMENT SPONSORED PROGRAMS OR GUARANTEES
MARCH 31, 1954-61

(millions of dollars)

Loans & Insured Mortgages	1954	1955	1956	1957	1958	1959	1960	1961
Guaranteed General Loans	133.6	125.3	152.1	162.3	169.2	197.8	210.8	233.1
Other Loans Guaranteed								
Cdn. Wheat Board Loans[1]	73.6	94.4	93.6	64.4	125.0	105.6	130.4	161.4
C.S.B. Loans[2]	109.0	98.0	114.0	115.0	116.0	111.0	127.0	127.0
Total Guaranteed Loans	316.2	317.7	359.7	341.7	408.4	414.4	468.2	521.5
Insured Mortgages	-	110.0	345.0	508.0	615.0	824.0	981.0	963.0
Guaranteed Loans and Insured Mortgages	316.2	427.7	704.7	849.7	1,023.4	1,238.4	1,449.2	1,484.5
Total Loans in Cdn. currency and Insured Mortgages[3]	3,902.0	3,984.0	5,248.0	5,708.0	5,737.0	6,305.0	6,937.0	7,223.0
Percentage of Guaranteed Loans and Insured Mortgages in Total	8.1%	10.7%	13.4%	14.9%	17.8%	19.6%	20.9%	20.6%

[1] Includes loans granted through the Wheat Board under the Prairie Grain Provisional Payments Act in 1960 and 1961, and under the Prairie Grain Advance Payments Act in the years 1958-61.

[2] Loans to finance the purchase of Canada Savings Bonds at time of issue.

[3] Excludes Canadian day-to-day and call loans.

Sources: Table 5; Bank of Canada, Statistical Summary, Financial Supplement 1957 to 1960, and July, 1961; Department of Finance, Public Accounts of Canada, Vol. 1, Part 1, various years; and Canadian Credits, The Royal Bank of Canada.

SECTION IV

DEPOSITS

154. Public attention is, perhaps, most often focused on the loaning and investing aspects of banking. But the ability of the chartered banks to carry out their loaning functions adequately depends on the way in which they perform, or are permitted to perform, as deposit institutions. This section includes a detailed outline of bank policies and practices in connection with deposits.

155. The Canadian dollar deposits held by the chartered banks for selected years since 1930 are shown in Table I, with the percentage represented by each type of deposit in Table II. Deposits by governments and other banks are usually repayable on demand, so are those of corporations, individuals, etc. which are listed under the heading "Other Current". Personal chequing accounts, which were first made available in 1957, are also included in the figures for "Other Current".

Deposits Repayable on Demand

156. Demand deposits, which now represent about 40% of total Canadian deposits, perform two closely related roles in the economy. As well as representing a store of liquid assets, demand deposits are used as the chief medium of payment in Canada. Their predominance is indicated by Table III which, however, omits transactions in cash and orders on credit unions and trust companies and bank money orders for which no comparable figures are available.

TABLE III

PAYMENTS MADE BY SELECTED DEMAND INSTRUMENTS IN CANADA

(Millions of Dollars)

Year	Post Office Money Orders[1]	Express Money Orders[2]	Federal Govt. Cheques[3]	Savings Cheques[4]	Current Cheques[4] Amount	Current Cheques[4] % of Total	Total
1955	669	133	4,879	8,786	152,565	91.3	167,032
1956	704	134	5,278	9,733	182,557	92.0	198,406
1957	800	135	5,844	10,207	195,352	92.0	212,338
1958	846	133	6,313	10,581	217,592	92.4	235,465
1959	853	126	6,773	11,958	244,285	92.5	263,995
1960	869	118	7,062	11, 840	265,970	91.2	285,859
1961	5	5	7,313	12, 787	289,904		5

Sources:

1. Dominion Bureau of Statistics, Canada Year Book, Annual.
2. Dominion Bureau of Statistics, Railway Express, Annual.
3. Canadian Bankers' Association.
4. Dominion Bureau of Statistics, Cheques Cashed in Clearing Centres, Annual. See footnote in this section for coverage of these statistics.
5. Not yet available.

TABLE IV

ANNUAL CHANGE IN
DEMAND DEPOSITS AND GROSS NATIONAL PRODUCT
CANADA-UNITED STATES COMPARISON

Year	CANADA Demand Deposits Total* ($ Millions)	Change	% Change	% Change in G.N.P.	UNITED STATES Demand Deposits Total** ($ Billions)	Change	% Change	% Change in G.N.P.
1935	569				22.1			
1940	875	+ 306	+ 53.8	+ 56.3	34.9	+ 12.8	+ 57.9	+ 38.8
1945	1,986	+ 1111	+ 127.0	+ 75.5	75.9	+ 41.0	+ 117.5	+ 112.3
1946	2,155	+ 169	+ 8.5	+ 0.1	83.3	+ 7.4	+ 9.7	- 1.4
1947	2,139	- 16	- 0.7	+ 11.1	87.1	+ 3.8	+ 4.6	+ 11.2
1948	2,259	+ 120	+ 5.6	+ 14.8	85.5	- 1.6	- 1.8	+ 10.7
1949	2,353	+ 94	+ 4.2	+ 8.1	85.8	+ 0.3	+ 0.4	- 0.5
1950	2,563	+ 210	+ 8.9	+ 10.2	92.3	+ 6.5	+ 7.6	+ 10.3
1951	2,712	+ 149	+ 5.8	+ 17.6	98.1	+ 5.8	+ 6.3	+ 15.6
1952	2,932	+ 220	+ 8.1	+ 13.3	101.5	+ 3.4	+ 3.5	+ 5.5
1953	3,081	+ 149	+ 5.1	+ 4.3	102.5	+ 1.0	+ 1.0	+ 5.3
1954	3,165	+ 84	+ 2.7	- 0.6	106.6	+ 4.1	+ 4.0	- 0.6
1955	3,592	+ 427	+ 13.5	+ 9.1	109.9	+ 3.3	+ 3.1	+ 9.5
1956	3,725	+ 133	+ 3.7	+ 12.7	111.4	+ 1.5	+ 1.4	+ 5.5
1957	3,676	- 49	- 1.3	+ 4.3	110.3	- 1.1	- 1.0	+ 5.6
1958	4,041	+ 365	+ 9.9	+ 3.1	115.5	+ 5.2	+ 4.7	+ 0.4
1959	4,028	- 13	- 0.3	+ 5.7	115.4	- 0.1	- 0.1	+ 8.6
1960	3,930	- 98	- 2.4	+ 3.3	115.1	- 0.3	- 0.3	+ 4.5
1961	4,111	+ 181	+ 4.6	+ 2.5	119.9	+ 4.8	+ 4.2	+ 3.3
1961/1935		+ 3542	+ 622.4	+ 753.5		+ 97.8	+ 442.9	+ 619.2
1961/1950		+ 1548	+ 60.4	+ 104.6		+ 27.6	+ 29.9	+ 83.2

* Average of month-end figures - Public demand deposits.

** Year-end figures.

Sources: Canada: Bank of Canada, Statistical Summary.
United States: Federal Reserve Bulletin.

CHART I

INDEX OF DEMAND DEPOSITS

1945 = 100

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TABLE I

Canadian Dollar Deposits in Chartered Banks

(Millions of Dollars)

At Dec. 31	1930	1935	1940	1945	1950	1955	1960	1961
Govt. of Canada	27	12	66	922	339	517	510	588
Prov. Govt	21	41	67	91	161	181	119	134
Other Banks	13	14	13	19	117	139	201	216
Other Current	642	641	1,031	2,063	2,770	3,915	4,301	4,701
Total Repayable on Demand	703	708	1,177	3,095	3,387	4,752	5,131	5,639
Personal Savings*	1,426)	1,486)	1,641)	2,865)	4,558)	5,633	7,215	7,618
Other Notice*	)	)	)	)	)	464	576	929
Total	2,128	2,194	2,818	5,960	7,945	10,848	12,922	14,186

TABLE II

Canadian Dollar Deposits in Chartered Banks

(Percentage of Total)

At Dec. 31	1930	1935	1940	1945	1950	1955	1960	1961
Govt. of Canada	1.3	0.5	2.3	15.5	4.3	4.8	3.9	4.1
Prov. Govt.	1.0	1.9	2.4	1.5	2.0	1.7	[illegible]	[illegible]
Other Banks	0.6	0.6	0.5	0.3	1.5	1.3	[illegible]	[illegible]
Other Current	30.2	29.2	36.6	34.6	34.9	[illegible]	33.3	33.1
Total Repayable on Demand	33.0	32.3	41.8	51.9	42.6	43.8	39.7	39.8
Personal Svgs.*	67.0)	67.7)	58.2)	48.1)	57.4)	51.9	55.8	53.7
Other Notice*	)	)	)	)	)	4.3	4.5	6.5
Total	100.0	[illegible]	[illegible]	100.0	100.0	100.0	100.0	100.0

*Before 1954 Personal Savings and Other Notice were shown together as "Other Notice".

Source: [illegible]

157. The total of payments made by cheques on current accounts has risen much faster in recent years than the balances maintained in such accounts, which have risen from an annual month-end average of $569 million in 1935 to $4,111 million in 1961, an increase of 622%. Although such deposits in Canada have increased faster than demand deposits in U.S. commercial banks, as shown in Table IV and Chart I, the pattern of post-war growth in the two countries is similar. Canadian and United States demand deposits moved up or down in the same direction in all but two of the fifteen years.

158. While demand deposits have not kept pace with the growth of Gross National Product, deposits in both countries expanded faster than output during the war years. Between 1940 and 1945 Canadian deposits rose 127% while Gross National Product increased by only 75%. Since monetary policy during this period was of necessity geared to an expansion of the money supply in order to facilitate the financing of the war effort deposits were permitted to increase sharply.

159. By the end of the war the money supply was at an unusually high level relative to G.N.P., and the rapid post-war growth in output occurred without a commensurate increase in demand deposits. Between 1945 and 1949 deposits increased by only 18% while G.N.P. rose 38%. During the 1950's there were alternate periods of monetary restraint and expansion, with restraint predominating. As a result, demand deposits increased by only 52% between 1950 and 1960 while Gross

National Product rose 100%. Nor has the trend reversed in recent years. Since 1955 G.N.P. has risen 36% but demand deposits only 14%.

160. This restriction in the growth of demand deposits in relation to G.N.P. is illustrated in Chart II. The Chart further shows the generally contra-cyclical pattern of bank deposit growth. In 1947, for example, while G.N.P. rose 11% demand deposits dropped 1%. In the 1951-52 Korean War period G.N.P. rose 33% but demand deposits were restricted to a 14% gain. Furthermore, in the 1956-57 recovery while G.N.P. rose 18% demand deposits increased only 2%. On the other hand, during the 1958 recession when G.N.P. rose only 3% demand deposits were up 10%.

161. However, the volume of payments made through the banking system has continually increased during the post-war period as shown by bank debits. Thus, changes in what is customarily called the velocity of circulation (The velocity of circulation is calculated by dividing total debits to individual accounts by an average of deposits. Since 1942 The Canadian Bankers' Association's monthly figures of total debits have been compiled to show separately the amount of debits to individual savings and current accounts in major clearing centres, and, in addition, since June 1957 separate figures have been compiled for personal chequing accounts. For these years, the approximate turnover of demand deposits may be calculated by dividing annual total debits to current accounts by the annual average of demand deposits. The resulting measure of turnover

TABLE V

VELOCITY OF DEPOSITS

	Demand Deposits		Notice Deposits	
	Velocity	Change	Velocity	Change
1945	23.61		1.25	
1946	23.05	− .56	1.23	− .02
1947	25.44	+ 2.39	1.18	− .05
1948	27.38	+ 1.94	1.19	+ .01
1949	27.24	− .14	1.16	− .03
1950	29.97	+ 2.73	1.27	+ .11
1951	33.89	+ 3.92	1.37	+ .10
1952	36.46	+ 2.57	1.35	− .02
1953	37.33	+ .87	1.49	+ .14
1954	38.11	+ .78	1.45	− .04
1955	38.53	+ .42	1.44	− .01
1956	43.01	+ 4.48	1.53	+ .09
1957	50.92	+ 7.91	1.54	+ .01
1958	52.11	+ 1.19	1.48	− .06
1959	57.99	+ 5.88	1.55	+ .07
1960	65.39	+ 7.40	1.54	− .01
1961	68.29	+ 2.90	1.52	− .02

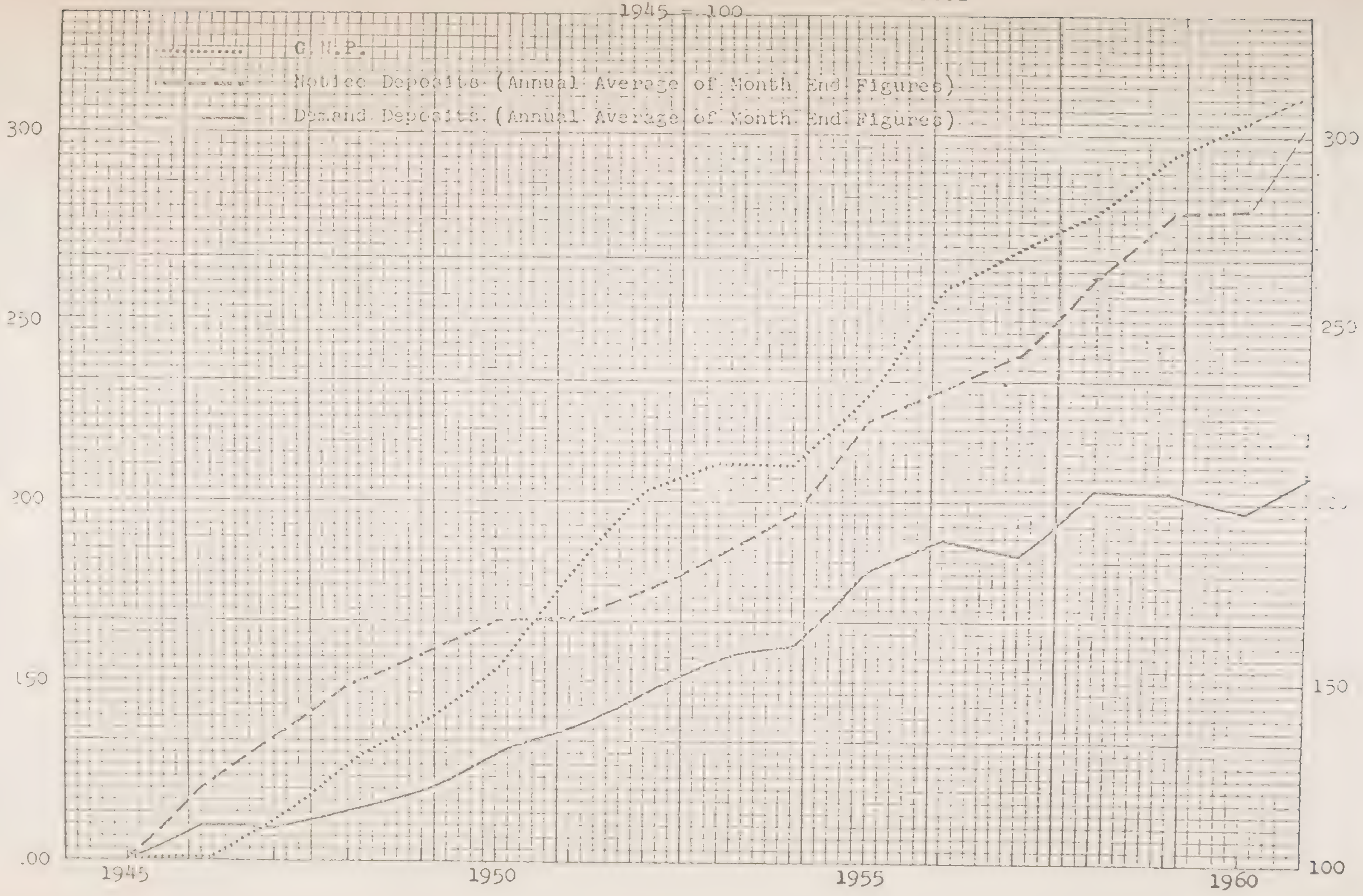
Note: Velocity is the ratio of cheques cashed to average month-end deposits. Cheques cashed represent total debits in 35 centres 1945-1957, and in all clearing centres after 1957 (52 centres 1958-60; 51 in 1961).

Source: D.B.S., Cheques Cashed in Clearing Centres, Annual.

CHART II

INDICES OF DEPOSITS AND GROSS NATIONAL PRODUCT

1945 = 100



will be somewhat understated as the figures for debits were compiled for branches in only 35 clearing centres prior to 1957 and 52 clearing centres since then. A survey conducted by The Canadian Bankers' Association in 1953 indicated the 35 centres provided 85% coverage. It has been established by survey that the addition of all remaining clearing centres in 1957 has increased the coverage to approximately 90%. However, the fact that the data are incomplete does not materially affect the resulting trend of turnover shown in Table V.) or the turnover of deposits have tended to compensate for changes in the quantity of money. Years of economic prosperity and credit restraint when deposits have been held down have been characterized by an accelerated rise in velocity. For instance, the turnover of demand deposits increased from some 38 times in 1955 to 51 times in 1957 as shown in Table V. In the post-war period turnover has risen in periods of prosperity as an increase in expenditures has swelled the volume of cheques drawn on demand deposits. In addition, there are other forces at work tending to increase velocity. During periods of tight money, the demand for liquidity in the form of deposits increases -- hence its value rises. The resulting higher short-term interest rates attract relatively inactive balances into interest-earning media with the result that these balances are activated. Since 1954 a money market in Treasury bills, finance company paper and other paper has developed and, as well, there have been substantial sales of Canada Savings Bonds. These media serve to transfer funds from

less active accounts to more active accounts thereby increasing over-all velocity.

162. In referring to a chartered bank deposit as less active it is not suggested that it was previously not being utilized in the economy. On the contrary, funds on deposit with the chartered banks are continuously employed in the banks' wide-ranging lending and investing activities. Neither is it suggested that these balances are lost to the banking system since the funds will be returned to the banks in the deposits of their new owners. However, when relatively inactive balances are invested in other interest-bearing media, the funds become available for a new series of transactions throughout the economy. Thus, while the volume of bank deposits remains unchanged, their velocity has been increased.

163. It may be of interest to note that velocity has been rising in other countries as it has in Canada. "Except for brief and mild declines during business contractions, the velocity of money in the United States (i.e., the ratio of the volume of expenditures to the stock of money) has increased steadily since the end of World War II. This is true for concepts of money that include and exclude time deposits and for such differing concepts of expenditures as total non-financial payments, debits to demand deposits, and the several variants of national income. Furthermore, it is true for most other prosperous economies as well. (Richard T. Selden "The Postwar Rise in the Velocity of Money." The Journal of Finance, December 1961 p. 483.

164. The second function of demand deposits is that of a store of liquid assets. Liquidity is defined as the relative ease with which assets can be converted into money and thus, besides serving as both a means of collection and of payment, demand deposits are, along with cash, the public's most liquid resource. Many other liquidity media compete with demand deposits as a store of value. While in Canada savings deposits are subject to notice of withdrawal, they are in practice accorded chequing privileges. Other savings media vary in their liquidity. Some such as deposits in competing savings institutions may be subject to chequing privileges, although such deposits are not officially considered a part of the money supply. For many other instruments, however, it is necessary to arrange for their sale or redemption and conversion into money before the proceeds can be used as a means of payment. There is frequently the additional risk of a fluctuating value.

165. Nine out of ten cheques and money orders issued in Canada are deposited into current accounts. Part of the banks' function as a depository then is to obtain payment for such items. Banks give immediate credit even though the collection of items which appear on deposits may take some time to effect. (This statement does not apply to items of $50,000 and over, which are cleared by wire.) A depositor in Halifax depositing a cheque drawn on Vancouver, for example, gets immediate credit in his account, even though it may be some days before the cheque is charged to the maker's

account in Vancouver. In the meantime, the bank has, in effect, financed the transaction. The cost of this float is heavy and the banks are constantly seeking ways to speed up the collection and clearing process by various means, including the increasing use of electronic equipment.

166. Although the banks do not pay interest on current account balances, if they permitted unlimited activity in the accounts without making a service charge, this could be considered a very high payment for the use of such funds. This was recognized by the Macmillan Report of 1933. As the report pointed out, if a charge were not made this "would result in the shifting of the costs of performing certain services from one class of customers to another class". (Report of the Royal Commission on Banking and Currency in Canada, Ottawa, 1933, page 74.)

167. While the operational procedures for personal chequing accounts vary widely between individual banks -- some, for example, sell cheque books at 10¢ a cheque and return cancelled cheques to their customers while others subtract the service charge (at a rate of 10¢ per cheque) from the account and retain the cancelled cheques -- the operation of a current account is basically the same in all banks. Current account customers receive a statement of account and cancelled cheques monthly and more often if required. Public acceptance of the personal chequing account is developing steadily but slowly. At December 31, 1961 the total amount outstanding in Personal Chequing Accounts was

only $104 million or just over 1% of total personal savings deposits.

168. Service charges are normally calculated by allowing one free entry per month for every $50 of minimum monthly credit balance. A charge of 10¢ is made for each additional debit and credit entry with a minimum monthly charge of $1.00. Where cheques are listed by the bank and charged to a customer's account in total, the charges are based on the number of individual cheques. In accounts which normally maintain balances of at least $2,000, but are subject occasionally to wide fluctuation, the allowance for free entries may be based on the average balance.

169. From time to time a bank will make a cost analysis of a customer's account and if it is evident that the service charge just described is inadequate in a particular case an additional amount is charged. It can be appreciated that current accounts vary so widely in the variety of services that may be provided that no single overall service charge can be applied to all customers of a bank. The question is further complicated by the permission granted to some important customers to issue their cheques as "Negotiable without charge at any branch in Canada, far northern branches excepted". Normally the remuneration given the banks for this par privilege is in the form of the maintenance of certain minimum deposit balances.

Government of Canada Deposits

170. The deposits of the Federal Government are allocated between the banks on an agreed ratio according

to each bank's share of the unrecovered costs of handling Federal Government business. Following an agreement reached in 1953 the banks have paid interest to the Government on some portion of these deposits. The present rate, negotiated in 1959, provides for interest at a rate of 10% below the average rate on accepted tenders at the weekly auction of three-month Treasury bills. This is payable on the amount by which the Government's minimum weekly balance at all banks exceeds $100 million. It should be pointed out that the Government accepts no obligation to keep a minimum of $100 million or more on deposit.

171. Some idea of the scope and growth of Government business handled by the banks is given by the number of Government cheques and other instruments cashed (excluding those of the Unemployment Insurance Commission) in the years 1951 and 1961. In 1951 some 36.8 million cheques were negotiated; in 1961 this figure had risen to 62.1 million, almost 9% of all cheques handled by banks in Canada.

172. While remuneration for some special services is paid on a per-item service charge basis, free balances are maintained by the Government and to some extent these recompense the banks for the heavy routine cheque and deposit handling functions. The question of the adequacy of remuneration for services rendered the Government is a matter of continuing concern to the banks. As outlined above while the banks pay interest on weekly balances in excess of $100 million, the Government is under no obligation to keep any free

balances with the banks. In spite of repeated requests compensation has not been put on a properly defined basis and it is now considered very inadequate in relation to the sharp rise that has taken place in the volume of government business.

173. Under Section 93 (1) of the Bank Act, the banks have been prevented from making any charge in respect of cheques or other instruments drawn on or payable to the Government, and the Government has not agreed to provide adequate compensation. Indeed it may be said that this forms a special burden not encountered by other industries in doing business with the Federal Government. As pointed out in the paragraph previously quoted from the Macmillan Commission of 1933, this, in effect, means that charges to other customers of the banks must be sufficient to offset the expenses incurred in handling Federal Government entries.

174. A section, similar to s. 93 (1) of the present Act first appeared in the Bank Act of 1890. That the relation of the Government to the banks has vastly changed since then is illustrated in the following table.

TABLE VI

GROWTH OF FEDERAL GOVERNMENT IN RELATION TO THE BANKS

	1890	1961	1961 ÷ 1890
	($ Millions)		(times)
Canadian Federal Govt. Budgetary Expenditures -	40	5,958	149
Gross National Product -	803	36,844	46
Canadian Dollar Deposits at Chartered Banks -	129	12,804	99
Federal Government Bank Deposits -	3	257	86

Sources:

1. Government Expenditures - Department of Finance, Public Accounts of Canada, for the fiscal year ended March 31, 1961.

2. Gross National Product for 1890 estimated by O.J. Firestone, Canada's Economic Development 1867-1953; for 1961, D.B.S. National Accounts.

3. Federal Government Bank deposits - Canada Gazette.

175. Government budgetary expenditures in the 1961 fiscal year were almost 150 times the 1890 figure, a much faster growth than either Government bank deposits or G.N.P. Even the foregoing is not a full measure of the increased burden on the banks, however, because there have come into existence in the last 30 years government policies involving various types of welfare payments effected by means of millions of small

cheques or other instruments for such purposes as Unemployment Insurance benefits, Family Allowances, Old Age Pensions, and so on. As previously mentioned, the number of such items has almost doubled in the last decade alone. The physical burden of these millions of payments is both heavy and costly, and could hardly have been envisaged when the privilege of exemption from charges was first embodied in the Bank Act.

176. The chartered banks make a very substantial contribution to government revenues by keeping 8% of their Canadian dollar deposits in Bank of Canada notes or in interest-free balances with the Bank. During 1961 such notes and deposits averaged $983 million.

Provincial Government Deposits

177. Provincial government deposits, unlike Federal deposits, have done no more than hold their own when compared with pre-war percentages. These deposit accounts operate in a similar manner to corporate current accounts but are separated on the banks' balance sheets for statistical purposes.

Deposits of Other Banks

178. Deposits by other banks in Canadian currency are also shown separately, and mainly represent accounts maintained by foreign banks in Canada. They are used to provide cover for drawings on Canada by these banks and serve to facilitate the encashment of Canadian cheques in the United States and other countries. For example, cheques of Canadian drawers cashed in Kansas City would be cleared by the American bank to the Canadian correspondent who would credit the deposit

account of the American bank with the proceeds. Canadian banks for similar reasons maintain reciprocal deposits with foreign banks. The growth of these deposits in Canada both in dollar amount and as a percentage of total Canadian dollar deposits is, in part, a reflection of the continued growth of Canada's foreign trade for which foreign banks have required larger deposits. Perhaps of some importance also, however, is the fact that Canadian banks are held in the highest regard in every part of the world as a safe depository. Part of the large growth in such deposits is, therefore, a reflection of the desire of foreign banks to have some liquid resources in the safety of Canadian banks. Deposits in foreign currencies, including those by foreign banks, are discussed later in this brief.

<u>Personal Savings Accounts and Other Notice Deposits</u>

179. As is evident in Tables I and II some 60% of total Canadian-dollar deposits of the chartered banks are now in the form of personal savings accounts or other notice deposits. The chartered banks have long been the most important savings institutions in Canada and, at latest count on September 30, 1961, the banks had over 10.8 million personal savings accounts on their books.

180. In view of the extent to which savings deposits make possible the broad credit operations of the banks they must be considered fundamental to our financial system. By the same token, it is important that the banks continue to hold a major portion of the

public's savings.

181. While demand deposits represent, in general, the "working capital" of individuals, organizations and companies, notice deposits are more likely to represent their reserves held pending a major expenditure or with investment in view, as a cushion in case of emergency, or simply the accumulation of savings built up over the years.

182. This distinction between demand and notice deposits is evidenced by the different rates of turnover for each type of account. From Table V it can be seen that the turnover of savings deposits in 1961 was 1.52 compared with a turnover of 68.29 for demand deposits.

183. The importance of savings accounts to the community arises not only through their role in facilitating savings but also in the uses to which the funds are put. The chartered banks play a vital part in our financial system as general credit institutions. Whereas other savings depositories tend to specialize in granting credit of certain types or for certain purposes, the chartered banks make their depositors' funds available to nearly all classes of borrowers to meet a great variety of credit needs. Consequently, they are able to direct savings into many channels to meet varying demands, and can shift easily and quickly from one use to another as demand warrants. This function is facilitated in Canada through the flexibility of the branch banking system by which funds may be made available in any part of the country as the

changing seasons and the varying needs of industry demand.

184. Chart II reveals the uninterrupted increase in notice deposits during the post-war period. It also shows that while their growth has been generally upward the rate of increase has varied in a contra-cyclical manner in much the same way and for similar reasons as earlier noted in the case of demand deposits.

185. However, during the 25-year period 1935-1960 Gross National Product has increased by 733% considerably in excess of the increase of 433% in notice deposits. Only during the immediate post-war period 1945-1950 did the percentage increase in deposits exceed that of G.N.P.

186. This disparity is not a reflection of a lower propensity to save on the part of Canadians. Indeed, if the savings in credit unions and Canada Savings Bonds are added to those in chartered banks the increase in savings so defined over the 25-year period amounts to 739%. Rather, the disparity between the growth of savings in chartered banks and G.N.P. is a reflection of the increasing importance of other avenues of savings.

187. The growth in chartered bank notice deposits has been encouraged by the increase in the number of branches operated by the chartered banks. These increased from 3,448 branches and agencies in Canada and Newfoundland in 1935 to 5,225 at the end of 1961, while the number of savings accounts has more than doubled. On October 31, 1935, the number of these accounts in

chartered banks stood at 4.0 million; by September 30, 1961, this figure had increased to 10.8 million. That the increase in number of branches has enabled the banks to reach a wider proportion of the population can be seen from comparing the growth in the number of accounts, 170%, with the growth in the population over the same period of only 68%.

188. Two other significant trends in savings deposits may be noted. First, the average size of individual savings accounts has shown a fairly consistent increase from $365 in 1935 to $711 in 1961. Second, in keeping with this trend, the proportion of individual accounts of under $1,000 has shown a steady decline from 92.6% of the total number of accounts in 1935 to 83.8% in 1961.

189. In deciding how and where to hold his savings, an individual will normally be governed by the following five considerations:

1. The safety of his funds;
2. The readiness with which his savings can be converted back into cash;
3. The rate of interest or other return received;
4. The ease and convenience of making the necessary transactions;
5. Other services offered in conjunction with the savings facilities.

190. The safety of deposits in Canadian chartered banks is today generally unquestioned. While there is no system of deposit insurance comparable with that in

the United States, the present strength of the Canadian banks almost precludes the possibility of failure. In addition, the chartered banks are held by tradition, by legislation and by sound management to high standards of prudence in their handling of funds entrusted to them -- standards which are much stricter than those applied by some competing savings institutions. Consequently, there have been no losses to savings depositors of Canadian chartered banks for more than 35 years, including the years of depression in the thirties. Also, of course, savings deposits are not subject to the risk of market price fluctuations, as are corporate securities and marketable government bonds.

191. While in general banks reserve the right to demand notice of withdrawal on savings accounts, it has not been the practice to require it. Bank savings deposits therefore are akin to currency in terms of their liquidity and consequently are an attractive form of saving. In addition, the savings customers of the chartered banks enjoy at a price full chequing privileges which enable them to make payments to third parties freely.

192. The convenience of savings deposits is enhanced by the widespread network of branches and subagencies of the chartered banks. Most Canadian towns and neighbourhoods have a branch or sub-agency of at least one of the chartered banks. The branch banking system makes possible the operation of branches in areas which could not support a comparable independent savings institution because branch banking operates most

economically.

193. The branch system of banking also enables the banks to offer all their savings customers, regardless of location, a wide variety of other services. These include: chequing accounts, credit facilities, safekeeping services, securities transactions, foreign exchange, financial information and counselling, and contacts with financial centres throughout the world.

194. The present rate of interest paid on savings accounts is 2-3/4% calculated on the minimum quarterly balance and paid half-yearly on the last day of April and October. Service charges are calculated quarterly with one free cheque allowed for each $100 of the minimum quarterly balance and a charge of 15¢ is made for each additional cheque.

195. Several of the banks have operated "Christmas Clubs" savings accounts. Another has provided a life-insured savings plan. No statistics for evaluating the acceptance of these special types of deposits are available from the individual banks for obvious competitive reasons.

Savings Deposits - Chequing Privileges

196. The practice of permitting customers to issue cheques against savings accounts, which is not customary in either the U.S. or the U.K., appears to have had its origin in the competition between Canadian banks early in the present century. The practice has disadvantages for the chartered banks as it materially increases the costs of operation of their savings departments. It was this fact that encouraged the banks

to introduce the Personal Chequing Account in 1957. It was felt that if savings accounts with high activity could be handled in a group with simplified procedures and not interspersed among less active savings accounts, handling costs could be considerably reduced and part of the saving passed on to the customer in lower service charges.

197. However, the privilege of issuing cheques on savings accounts has been widely used by the public. It provides for the banks' customers a higher degree of liquidity and convenience in the use of their accounts than would obtain if the practice were discontinued. As mentioned, these two factors of liquidity and convenience, are important in the public's choice of where it will hold its savings.

Other Notice Deposits

198. The category of other notice deposits includes the savings deposits of institutions and corporations which are maintained, charged service charges, and paid interest in exactly the same way and at the same rates as are Personal Savings Deposits.

199. With the rise in yields obtainable on Government Treasury bills in the 1950's corporate treasurers began to invest surplus working funds, most of which had been held in bank current accounts, in interest-earning securities. At first the investments were mainly in Treasury bills and finance company paper. Later, as the market developed, investments were also made in repurchase agreements with and day-to-day loans to investment dealers and to inter-corporations [illegible]

as grain companies, large retail and chain stores, and some provincial and municipal governments. To meet this competition and to avoid having to force their own customers to deal elsewhere the banks developed short-term interest-bearing deposit instruments of their own. These include fixed-term deposit receipts for larger amounts, terms for which were revised in 1961. Receipts are issued for deposits of $25,000 and over, left for terms of 30 to 364 days. The rates are revised periodically in reflection of money-market conditions; at the time of writing they run from 3-1/8% for 30 to 59 days to 3-7/8% for 270 to 364 days. Receipts are not negotiable and the deposits may be withdrawn before the agreed term but with an interest penalty. Although fixed-term deposit receipts account for slightly less than 1% of personal savings deposits they are a very significant factor in the other notice deposits of the banks which have increased substantially since the new rates were introduced.

200. In addition, one of the chartered banks in 1960 began issuing term notes with maturities of from 1 to 6 years. These notes are issued in amounts of $10,000 and up and are negotiable. The rates are set from time to time; at present they run from 4% for notes under 2 years, to 5% for notes with a maturity of between 5 and 6 years.

Deposit Insurance

201. In contrast to the situation in Canada where there is no deposit insurance, perhaps the most striking feature of U.S. regulations for the safety of

depositors is the deposit insurance provided under the Banking Act of 1933, which established the Federal Deposit Insurance Corporation (F.D.I.C.). Out of a total of 13,999 banks in the United States at the end of 1960, 13,451 participated in the insurance scheme. At that date the deposit insurance fund amounted to $2.2 billion, or 0.85% of total deposits in insured banks. Participating banks must insure the deposits of each of their customers up to a maximum of $10,000 by paying an annual premium to the Corporation of 1/12% of their total deposits. A portion of this premium is returned to the banks each year after allowing for payment of losses and expenses of the Corporation.

202. In the unit banking system of the United States, the F.D.I.C. is a valuable guarantor of safety to the vast majority of depositors who keep their money in the numerous small banks throughout the country. This deposit insurance system promotes safety in two ways:

(1) It stands ready in emergency to protect depositors and maintain confidence in the banking system; and

(2) it requires its many policy-holding banks to observe certain standards of safety, thus raising the average stability and safety of the whole group.

203. However, the situation in Canada is quite different. Each of the Canadian banks is large enough and strong enough to stand alone without deposit insurance and we see no need for the introduction of

insurance.

The Segregation of Deposits by Term or Type

204. There are a number of considerations involved in any proposal to differentiate among types of deposits in the chartered banks for reserve or lending purposes. Not only are there implications for monetary control and asset management but also the repercussions of any proposed changes in the public's attitude to and confidence in Canadian banking are of fundamental importance.

205. As noted in Table V the velocity of circulation of current account deposits is much higher than for savings accounts. It is on the fundamental facts of the greater stability and lower velocity of notice deposits that suggestions have been made from time to time that the chartered banks might quite properly engage in a much larger way in long term financing, including conventional mortgages. It has been suggested that one way of doing this would be to "notionally segregate" term deposits from current deposits for long-term lending purposes.

206. However, this would introduce an unnecessary rigidity into the structure, as there need be no formal link between the term of deposits and the term of loans. From the community's point of view the over-all problem is to achieve a balance in the total supply of and demand for financial resources. It has been the function of financial organizations, especially the banks, to receive the savings and working capital of the community for varying terms and to apportion them

as loans or investments at short or long term as circumstances warrant.

207. Within the over-all pattern there are specialized intermediaries, but the banks are the logical institutions to undertake the key role in the allocation of credit. On the one hand the banks' deposit obligations are a ready substitute for currency and are universally acceptable. On the other hand they lend to the widest variety of borrowers and in the most varied ways. Moreover, in the case of bank loans to other intermediaries, the banks to some extent are lenders of last resort.

208. On a number of occasions the Bank of Canada has moved to influence the investing policies of the chartered banks. On one occasion in the early post-war period there was a limitation on the amount of Government of Canada bonds banks could hold and the amount they could earn on these bonds. More recently the situation has been completely opposite and the Bank of Canada has insisted, in connection with the 15% liquidity ratio, that a minimum investment must be maintained in the form of Treasury bills and day-to-day loans.

209. It might be considered that one way to encourage increased investment by the banks in longer-term instruments would be to permit a lower cash reserve against savings accounts. In the United States there are lower cash reserve requirements for the savings deposits of the commercial banks than for demand deposits. The difficulty with this is that cyclical [illegible] shifts between demand and time deposits create

complications for monetary control. The whole problem of cash reserves has been discussed earlier in the brief and it is perhaps sufficient to say here that it is hardly satisfactory for a situation to exist that could work in the opposite direction to the policy of the central bank.

210. There is, however, another aspect of the general problem of longer-term lending by the chartered banks that also concerns the central bank. Canadian banks have for many years been relatively immune from a liquidity crisis such as developed in the United States in the 1930's. In large measure this has been the result of asset management policies that kept adequate reserves for any foreseeable emergency or periods of contraction. Nevertheless, it is one of the prime functions of a central bank to act as the lender of last resort to the banking system. If the Canadian chartered banks enter more heavily into longer term investments, it would appear logical that the Bank of Canada be prepared to accept for rediscount some of the longer term instruments that would be acquired by the banks in the process and for longer rediscount periods than would be now possible.

211. In summary, we are opposed to any attempt to segregate deposits by term or type because we believe the result would be to introduce undesirable rigidities into the financial system.

SECTION V

FOREIGN CURRENCY BUSINESS

The Foreign Exchange Market

212. The active participation of Canadian chartered banks in foreign currency operations of all sorts is a natural corollary of the great importance to Canada of foreign trade. If Canadian banks were not in a position to provide the whole range of banking services necessary for carrying on an extensive export and import trade, Canadians requiring these services would have to obtain them from foreign bankers, and this would have a considerable adverse effect on our current account balance of payments. To the extent that Canadian banks are able to go beyond providing such services to Canadians and are able to compete successfully with foreign banks for further international business, there is an additional favourable impact on our balance of payments. Revenue from banking services is, in short, a significant item in the balance of payments, and the success of Canadian banks in the intensive competition with foreign bankers is important to Canada in the same way as success in holding and extending our export markets generally.

213. The foreign currency business of the banks arises out of all transactions with foreign countries, such as imports, exports, investment of all kinds, payment for services, interest, dividends, profits remittances, gifts, tourism, etc. Foreign currency transactions include all types of transfers, cheques,

drafts, currency, bills of exchange, and so on. Bankers' commercial letters of credit are also used extensively to ensure prompt payment according to specified terms.

214. In obtaining payment for exports, settlement may be taken in the currency of the country of the importer, provided the currency is reliably convertible and there is an adequate forward market, otherwise it may be in the interests of both buyer and seller to negotiate for payment in a key currency such as U.S. dollars, which also offers the advantage, if financing is required, of extensive credit facilities at low rates of interest.

215. The Canadian banks provide a wide variety of methods of payment for imports. Both the Canadian importer and the foreign exporter can have their interests safeguarded by employing a Canadian bank commercial letter of credit, the terms of which can be made to suit the requirements of a particular transaction.

216. Banks in Canada are active in the forward markets for the key currencies, U.S. dollars and sterling, and for all the other free currencies for which there is a forward market. Any foreign currency that enjoys a forward market against one of the key currencies can, of course, be traded forward in Canada with the same facility. Forward trading in U.S. dollars and sterling is active up to six months, while less active trading takes place beyond six months up to a year. Any forward trading beyond one year would be subject to negotiation. Ordinarily the forward rates bear a close

relationship to the difference in short-term interest rates between the countries concerned. Other factors, such as commercial supply and demand or the predominance of speculative pressure due to fears of devaluation or revaluation may affect the rates and ability to trade forward freely on a reasonable basis. Forward facilities enable exporters, importers and others to fix their exchange commitments. Banks may grant customers optional periods within which they may make delivery or take delivery of foreign currencies under forward contracts relating to trade and payment for services. Forward trading between banks is for fixed dates only. In granting customers optional delivery periods, banks' forward positions often become temporarily distorted through the exercixe of these options. The handling of these operations requires the use or availability of substantial capital.

217. The handling of the foreign exchange business of the chartered banks is centred in the International or Foreign Exchange Departments of the individual banks where specially trained staff are in charge of the trading. These departments maintain contact with each other through foreign exchange brokers employed on a salary basis by The Canadian Bankers' Association. This Canadian foreign exchange brokerage procedure, introduced in 1950, has proved highly successful, resulting in greater activity and narrower spreads between buying and selling rates.

218. The individual trading departments of all also maintain constant touch with other foreign

exchange markets in New York, London and continental Europe through private telephone and telex services, public telex and fast cable and telegraph connections. Foreign exchange operations are facilitated by the foreign agencies of the Canadian banks located in New York, London and elsewhere, which are in constant communication with their local markets. Other New York and London banks, as well as the large European foreign exchange trading banks, also are in direct telephone or telex communication with the foreign exchange trading departments of the Canadian banks, which, in turn, have ready access to the Canadian foreign exchange market on the basis of the special brokerage arrangement referred to above.

219. The foreign exchange trading departments of the banks maintain constant contact with their central branches across Canada, furnishing the latter by wire or telephone with particulars of the latest foreign exchange quotations. These central branches in turn keep in touch with any branches having any special interest in a particular currency for account of interested customers. Under this system all branches can offer their customers the facilities available in the largest foreign exchange trading centres at a minimum of cost, whether these requirements relate to transactions for spot or forward delivery. This organization is also available for the gathering and dissemination of special information relating to the latest developments affecting foreign exchange rates, foreign exchange regulations in countries operating under foreign exchange control,

and any other information of interest to importers and exporters and others in Canada interested in international financial transactions.

Foreign Deposits

220. In recent years banking has been taking on an increasingly international flavour, involving short-term deposits denominated mainly in United States dollars but also including sterling and some other currencies. Canadian banks have always accepted United States dollar deposits for the convenience of customers wishing to hold their balances in this way; the principal users have been Canadian exporters, Canadian companies operating plants in the United States, and customers requiring a depository for investment capital awaiting exchange into Canadian dollars or repatriation to the United States. However, banks in many European and other countries also accept deposits and make loans denominated in U.S. dollars or sterling, which have come to be known as Euro-dollar and Euro-sterling transactions. There are similar but less-well-known external markets in other currencies as well.

221. International differentials in interest rates are a factor in the spread of such practices. Thus for example the deposit interest rates offered by U.S. banks have for some time been lower than comparable rates in most other countries, with the result that holders of dollar balances, whether residents or non-residents of the U.S.A., have been able to obtain higher interest rates by directly or indirectly lending such balances to borrowers abroad. Until recently the

relatively low level of deposit interest rates at U.S. banks was usually attributed to the maximums set for member banks of the Federal Reserve System under Regulation Q. While these maximum rates have recently been liberalized, the deposit rates of U.S. banks have not uniformly risen to the full amount now permissible and in many cases remain below comparable rates abroad.

222. Other factors are also involved, however, including the widespread demand for sterling and dollars as key currencies in world trade, the return of more normal foreign currency trading conditions following the war, the building up of official foreign exchange reserves by the principal trading countries, and the convertibility of major currencies on non-resident account. Speculation on exchange movements has also been a factor at times. U.S. dollars, external sterling and certain other currencies are free of all foreign exchange controls, and in the case of the United States dollar such funds have been readily available in large amounts at relatively low rates of interest. Sterling and the principal European currencies have the further advantage of being free of U.S. foreign assets control regulations.

223. Euro-dollar and Euro-sterling funds are highly volatile and, therefore, are commonly employed in call and other short-term loans and investments such as treasury bills, short-term Government bonds, U.S. dollar finance company and commercial company short-term paper, and other first-class short-term investments, including short-term financing of [illegible] trade. In some

cases these funds are used in countries outside the United States and United Kingdom on a swap basis.

224. The growth of foreign currency deposits on the books of the Canadian banks since 1958 has been substantial, much of it on a fixed-term basis. At the beginning of that year they were a little over $1.8 billion but now amount to nearly $3.5 billion. This growth, of course, has not been confined to Canadian banks, since institutions in other countries have been aggressively competing for such deposits and the volume of transactions in international centres, especially London, has been impressive.

225. The success of the Canadian banks in this field is undoubtedly due to their reputation as depositories having regard to their own sound financial positions, their location and the relative political and economic stability of the country, as well as to the competitive rates of interest which they are able to offer. The volume is not entirely due to rates of interest, as many depositors prefer to use Canadian banks because of fear of international disturbances, blockage of funds and other considerations.

226. It may be noted that the acceptance of U.S. dollar deposits by non-U.S. banks is very similar to the flow of funds into U.S. non-bank financial intermediaries, insofar as the effects on the U.S. economy and the U.S. banking system are concerned. When a U.S. dollar deposit is made in a foreign bank the foreign bank simply acquires a claim against (i.e. a deposit in) the particular U.S. bank, just as a U.S. savings and

loan association or other domestic savings institution does when a deposit is made in it. The foreign bank may then lend or invest these funds, just as a domestic savings institution would do but this merely transfers the existing deposit to a third party. The U.S. money supply is not affected one way or the other, though the velocity of circulation is increased. Corresponding domestic effects may be ascribed to transactions in Euro-sterling or in any other currency for which there is a significant external market of this kind.

227. Canadian funds, of course, may flow into foreign banks in the same way as foreign deposits come into Canadian banks, depending on interest rates and the level of premium or discount on Canadian funds for forward delivery. In addition, non-resident banks seeking short-term funds compete in Canada for Canadian dollar deposits with the Canadian banks, trust companies, or other short-term borrowers such as the finance companies, etc. When interest rates abroad, after swapping costs, produce yields higher than in Canada, such Canadian funds may find their way into United States dollar or sterling fixed-term deposits, or other forms of investment expressed in those currencies. This situation is subject to constant change depending on the factors referred to above. In general deposit liabilities are offset by assets in the same currency, hence the risks of an exchange position are avoided.

228. This whole process is part of the mechanism of adjustment which keeps international interest rates

in line. Hence, from the point of view of Canada as a whole, the net result of the competition of Canadian banks in this field has been a contribution towards stabilizing our balance of payments position on current account.

229. The following statistics show the comparative growth of Canadian dollar deposits and foreign currency deposits of the chartered banks during the period 1954 - 1961:

CHARTERED BANK DEPOSITS
($ Millions)

As at Dec. 31	Canadian	Foreign Currency		
		Banks	Others	Total
1954	9,683	82	948	1,030
1955	10,848	106	950	1,056
1956	11,162	234	1,135	1,369
1957	11,407	270	1,557	1,827
1958	12,690	427	1,649	2,076
1959	12,279	530	1,842	2,372
1960	12,922	647	2,007	2,654
1961	14,186	703	2,785	3,488

Foreign currency deposits of the chartered banks show a more rapid rise than Canadian dollar deposits during this period of greatest growth. There is no detailed tabulation available of the ownership of these foreign currency deposits. However, in addition to the deposits of U.S. and other origin already mentioned, some Canadian funds have been swapped into U.S. dollars for short-term investment. The last mentioned transactions

developed in part because of intense competition within Canada between banks, trust companies, investment dealers and finance companies for deposits, and in part because of competition from certain foreign banks active in the international money markets who were prepared to offer this facility to Canadian depositors. Deposit and lending rates are quoted between banks operating in this field of activity at very narrow spreads allowing little margin for losses, commissions or costs.

230. In the matter of reserve requirements on foreign currency deposits lodged with banks here, the following should be considered:

(a) Large cash reserves are already carried on deposits with other prime banks.

(b) Banks in most other countries competing for foreign currency deposits are not restricted by reserve requirements. Any restrictions, penalties, or conditions placed on Canadian banks and not similarly placed on foreign branches of American banks, banks in London, and on the Continent would unduly handicap the Canadian banks in this business.

(c) These funds are substantially invested on a short-term basis; a heavy percentage is always invested in treasury bills, and call loans against bills and securities represent a further substantial percentage.

(d) The swapping of Canadian funds to U.S. dollars and sterling for short-term investment

is relatively unimportant, considering that there is also a reverse flow of funds into Canada on the same basis. In any event, swap rates in addition to interest rates have a restrictive effect on the amount of funds that can be shifted from one currency to another on a swap basis.

SECTION VI

BANKS IN THE SECURITIES BUSINESS

231. The discussion of the short-term money market in later pages indicates the active and continuous participation of the banks in the Canadian securities market for their own accounts. The diverse nature of these activities keeps the banks constantly in touch with market conditions over almost the entire field of securities.

232. The banks maintain active trading desks in their head offices, and they also conduct trading operations in their main city offices across the country. At head office, the trading desk is used to implement decisions relative to the management of the banks' cash reserves -- making and calling day-to-day loans and buying and selling Treasury bills and other securities. In order to keep abreast of day-to-day markets, the banks conduct trading with the investment dealers and brokers. The "street" market is also used to buy and sell securities to meet the requirements of customers.

233. In addition to the investment transactions carried on through their trading desks, banks have two other important operating functions in this field: the underwriting and retail distribution of securities.

Underwriting

234. The economic development of Canada depends [illegible] continuing expenditure by provinces, municipalities ([illegible]lated public bodies), and corporations, on

capital assets such as roads, bridges, pipelines, schools, utilities, factories, equipment, etc.

235. In the initial stages of such projects, the accepted procedure is for established sponsors of such undertakings to obtain short-term loans from banks. At a later stage the capital asset requires long-term capital financing usually of a term that will correspond roughly to the life of the asset, e.g., municipal local improvements are usually financed for a term of ten years by serial debentures maturing 1 to 10 years, whereas financing of schools, sewers, and utilities tends more towards a twenty-year term or longer. In the transition from short-term bank loans to long-term capital financing, the banks are particularly able to provide an effective liaison.

236. The interest of the banks in the financial affairs of their customers stems from the knowledge that sound financial management contributes materially to the growth, development, and well-being of the customers. Therefore, the banks continue to give full consideration to the customers' best interests as financing moves from short-term bank loans to longer-term capital requirements in the market place. It is the banks, therefore, which, in many such transactions, prove to be the most effective liaison in completing the successful transition from temporary to long-term financing. Consideration must be given to the ways and means of most satisfactorily obtaining capital and this involves the tailoring of capital issues in a fashion that will ensure the successful placement of issues in

the market place where the issuer (seller) is desirous of incurring the lowest possible interest cost and the lender (buyer) anxious to obtain the highest possible interest return.

237. A balance between these two extremes can only be achieved by bringing to the market place issues which are properly conceived as to:

(a) time of issuance -- when the market will be receptive to issues properly designed as set forth below;

(b) term of maturity -- consideration must be given to market preferences for short-term or long-term issues and also to the term most desirable to the issuer;

(c) coupon rates which will attract investors with current buying interest;

(d) long-range considerations such as the need for further financing, so that recourse to the market will not be delayed in such a fashion as to create a major pile-up of accumulated financing. Regular, orderly financing will familiarize the market with the borrower and avoid the need to do too much financing at times when money is tight and expensive;

(e) pricing in a manner that is equitable for both borrower and lender.

238. The banks make their advice available to customers contemplating public financing and their experience in the securities markets equips them well to

perform the task. Frequently a bank will participate in the underwriting of high grade security issues and for this purpose will associate only with experienced and reputable partners in an underwriting syndicate. In their respective syndicates, the banks assume a share of the liability and also share proportionately in the net profit or loss resulting from the undertaking. It should be noted that the banks work in partnership with investment dealers in underwriting issues except on occasions where the amount involved is less than $50,000 or the term is short.

239. If the offering prices of the securities are sufficiently attractive relative to the demand for their available resources, the chartered banks may purchase securities of appropriate term for their own account from the successful syndicate at the offered price. The successful syndicate looks to the bank or banks, if any, in that syndicate to finance the carrying, pending sale, or any balance remaining unsold at delivery date; there are no known instances where such assistance has not been forthcoming. This is a particularly useful service in the not infrequent periods of market "indigestion".

240. There has been some criticism from time to time, by some investment dealers, of bank participation in underwriting ventures. On examination, the details of such criticism do not seem to be valid. Some investment dealers appear to have the view that, inasmuch as the number of syndicates wishing to bid is frequently greater than the number of banks which are interested,

some dealers or syndicates are, accordingly, penalized, and it is suggested that the banks should, therefore, withdraw completely from the underwriting of securities. A variation of the same argument is that the syndicate containing the borrower's banker or bankers has an unfair advantage in competitive bidding in that the banker will support only his own syndicate.

241. This criticism is not valid. Any lack of buying interest exhibited by the borrower's banker in particular, or by the banks in general, when an issue is re-offered for sale by another syndicate, is based on the offering price, and alternative opportunities for the utilization of available resources. To exclude the banks from the originating syndicates would not solve this problem. Competing dealers would undoubtedly try to obtain orders in advance from the bank or banks that were considered likely to be interested.

242. As an indication of the important role banks play in this field, several of the largest borrowers in Canada, who sell their issues by private negotiation with a syndicate, have requested that a bank (or banks) be included in the negotiations in order to obtain the benefit of the banks' views in conjunction with those of the investment dealers.

Retail Distribution

243. A very important role is performed by the chartered banks in effecting a low cost, efficient, and widespread distribution of securities throughout Canada. A complete securities service is available to customers

at even the smallest branches. In the major financial centres most of the banks have specialized staff and facilities through which customer transactions are channelled.

244. The banks do not consider it their function to "give advice on the stock market" but do accept orders from customers. Such orders to buy and sell stocks are routed from all branches to central points where the execution of the orders is handled by stock brokers. The banks usually make a handling charge for ensuring the safe delivery of securities.

245. The handling of customers' orders for bonds and debentures is somewhat more complex than for stocks; while the procedures vary in certain minor respects from bank to bank, the following outline is typical of most banks. Each branch is provided with a bulletin listing current bid and asked prices on all or nearly all Government of Canada market issues and certain provincial, municipal, and corporate bonds, for which an active market exists. Within certain limits as to amounts, all branches are authorized to effect transactions on the basis of the bulletin prices. Bulletins are revised and distributed to branches as frequently as market changes occur. Because the distribution of bulletins is usually from a number of central points, perhaps as many as 7 or 10, the information and up-to-date service is usually available in even remote areas in less than two days after the change in either market prices or availability of issues.

246. In the case of bonds sold to customers at

the bulletin prices, the branches requisition delivery through the central points. On the other hand, bonds purchased from customers are shipped periodically by branches to the central points. In either case, and particularly in the latter, some time elapses before the central points at which market trading occurs are aware of the extent to which their position may be affected by the volume of customers' bond transactions in process.

247. This float of transactions, which can at times be very large in total, (even though the individual transactions are small) is carried by the banks without compensation other than accrued interest. The market risks that can evolve during the period of the float are absorbed by the banks, and if market prices move sharply in either direction the banks can lose because of the time lag; periods of substantial customer buying are often accompanied by rising prices, and bonds will be sold to branch customers several days before the central points are aware of the magnitude of the purchases they are required to make to cover the position, whereas weak markets are usually typified by substantial selling and declining prices, and bonds acquired by branches from customers do not reach the central point where they are to be sold for even longer periods.

248. In the case of any transaction, and of enquiries relating thereto, no branch is further removed from the market place than local telegraph or telephone facilities. The central points are well equipped to

handle communications and transactions relative to all sorts of market activities.

249. In the field of retail distribution, the banks play a particularly valuable role in facilitating the sale of new issues to many interested investors over a very wide area. The vast branch network permits distribution to investors in communities where other reliable means are either non-existent or not as conveniently available. While such communities obviously include those far removed from financial centres the service is equally valuable from the viewpoint of customers' convenience in residential, industrial, commercial and financial areas of the large metropolitan centres. In order to assist customers with the investment of their funds, branches are kept informed by bulletin or by periodic notification by mail, telephone or telegram, of a wide variety of issues both outstanding and new.

250. Widespread retail distribution of new issues is also facilitated by banks' participation in syndicates. Through their branch networks the banks can distribute securities by filling orders from customers in localities where it would not be practical for an investment dealer to have a representative. As a service to small buyers it has frequently happened that banks have sold bonds to their customers in outlying areas at issue prices for as long as a week to ten days after the market moved to a premium, retaining bonds until such time as the customer with funds for investment has had notice, by newspaper advertisement or otherwise, of the

availability of the issue. Under these conditions, the position of the small investor is not prejudiced by immediate action of the large sophisticated investor who is in constant touch with market offerings.

251. A notable example of the important role played by the banks in the field of distribution of securities is apparent in the annual sale of Canada Savings Bonds. The banks' sales to customers represent 2/3 to 3/4 of the total issued. In addition, the banks handle a large volume of payroll savings plans and servicing of investment dealers' sales.

SECTION VII

MISCELLANEOUS SERVICES

252. Apart from the principal services which the chartered banks perform for their customers in the way of making loans, conducting deposit accounts, buying and selling foreign exchange, they also provide a wide variety of other services, some of which are discussed in the following paragraphs. For many of these services the banks usually receive commissions, fees or rentals, although a number of them are provided free as a service to their customers or to the community.

253. The chartered banks also provide a fast and efficient system of remitting funds to almost any part of the country by means of mail or telegraphic transfers. In addition they issue a large volume of drafts and money orders which provide for their customers a convenient form of making payments to third parties. Drafts and money orders are also issued in foreign currencies and are readily negotiable in almost any part of the world.

254. For persons travelling either in Canada or in foreign countries the banks provide a safe, convenient method of carrying funds in the form of travellers' cheques or travellers' letters of credit.

255. As more and more Canadians have acquired the habit of investing part of their savings in securities there has been a growing demand for safekeeping facilities. To meet this demand the chartered banks offer two kinds of services. They accept securities and other

articles of value for safekeeping in their vaults, and in most branches they have installed safety deposit boxes for the use of their customers. In the case of securities left with them for safekeeping, the banks will collect the revenue as it becomes due and credit it to the customer's account. For customers who accumulate receipts outside normal banking hours, night depository facilities are provided.

256. The chartered banks accept payments of accounts such as light and gas bills, telephone bills, and municipal taxes, and these amounts are remitted to the principals or credited to their accounts. The banks lend their support to various charitable organizations by agreeing to receive and remit donations during fund-raising campaigns. Customers of the banks may also arrange to have regular remittances for rent, mortgage payments, insurance premiums, etc., charged to their accounts and sent to third parties. Other customers arrange to have their payrolls made up in pay envelopes by their bank, or paid in the banking office or credited to employees' accounts.

257. The collection of bills of exchange and promissory notes for their commercial customers has traditionally been an important function of the chartered banks. With the decline in the use of the bill of exchange as a means of settlement this function has diminished somewhat in recent years. Nevertheless, the number of such items being collected through the banking system is still large.

258. The chartered banks frequently act as agents

for their customers in purchasing or selling stocks and bonds, arranging transfers, and deliveries to third parties, and exchanging interim certificates for definitive certificates or bonds. In this respect, the banks are not attempting to compete with regular dealers in securities but are merely providing a service to many of their customers, especially those who reside in the smaller centres.

259. During the two world wars the banks gave their support to the various Victory Loan campaigns, and since 1946 they have been active in promoting the sale of Canada Savings Bonds. The banks arrange for the issue of these bonds for cash, on monthly savings plans operated by the banks, or through employers on payroll deduction plans. They also register the bonds and are prepared to redeem them at any time on behalf of the Bank of Canada.

260. In recent years the growing use of credit both by businesses and by individuals has increased the need for reliable credit information. It is customary for people seeking credit to give the name of their bank as a reference and for those giving credit to seek credit information through the banks. Recognizing the unique relationship that exists between the bank and its customers, the banks are particularly careful to use the utmost discretion in the handling of credit enquiries, and the preparation of credit reports are invariably entrusted to senior personnel in the branches.

261. The chartered banks are frequently called

upon by their customers and people abroad to provide information on particular industries, areas, or business conditions in general. To meet this demand the banks maintain research and business development departments, and publish a wide variety of pamphlets and booklets on topics of interest to businessmen. Most of the banks also publish monthly letters. For many corporations and municipalities the banks act as consultants on financial matters. They also act as redemption agents for the payment of their bonds, coupons and dividends.

262. In a smaller, but no less important way, the managers of the banks' branches serve their customers by providing advice and information on many day-to-day financial and business problems.

263. In addition to providing their customers with foreign exchange and the machinery through which foreign payments are made and financing the flow of goods between Canada and other countries the chartered banks also provide a variety of services to exporters and importers. This includes up-to-date information on foreign exchange regulations abroad.

264. An important consideration for Canadian exporters is the credit standing of their foreign customers. The chartered banks, through the use of a network of foreign agencies and correspondents located in all parts of the world, are able to obtain reliable credit information for their customers. Frequently chartered banks will be asked by foreign companies or by their bankers to suggest the names of Canadian dealers who

could handle their products. On the other hand Canadian exporters frequently ask their bankers to obtain, through their foreign correspondents, the names of brokers or dealers abroad who might prove a satisfactory medium for selling their products.

265. Representatives of the foreign departments of the chartered banks travel abroad frequently to develop new business and to gather information which may be of use to the banks' clients in Canada. During these visits abroad contacts are established with prominent bankers and businessmen in the countries visited, and the benefit of this liaison is made available to importers and exporters in Canada.

SECTION VIII

INSPECTION

266. An important feature of the operations of the chartered banks and one which distinguishes them sharply from competing financial institutions is the existence of rigorous inspection procedures. These procedures are both internal, provided by the banks themselves, and external, provided by the shareholders' auditors and the Inspector General of Banks.

267. The practice of internal inspection by banks is one of long standing, and important benefits in control and efficiency are derived from the procedures which have been developed through many years of experience. Each branch and some departments of the bank are inspected annually on a surprise basis. This involves verification and evaluation of assets and liabilities in these units, including assessment of loan risks and critical examination of collateral security. Application of official rules and instructions is checked and any irregularities of consequence are reported to head office. In addition it is the duty of inspecting officers to observe and advise on branch operating efficiency and, among other things, to ensure that policies formulated at the executive level are carried out in all branches. Inspecting officers are attached either to district administrative departments or to head office. However, they report directly to head office and are expected to be as objective as possible in their appraisals.

268. Section 61 of the Bank Act requires the shareholders at each annual meeting to appoint two qualified auditors, whose duties include reporting to the president and the general manager concerning any transactions or conditions that, in their opinion, require rectification; any such reports must be submitted to the next meeting of the directors. The auditors must also report to the shareholders at the next annual meeting on the statement of bank assets and liabilities.

269. The duties of the Inspector General of Banks as provided in section 63 of the Bank Act are briefly:

(1) to satisfy himself that provisions of the Bank Act for the safety of creditors and the shareholders are being observed and that the bank is in sound financial position and to report the results of his examinations and findings to the Minister, and

(2) to certify to the Minister that the returns relating to cash reserves are correct.

270. The periodic inspection by the Inspector General supplements the internal inspections conducted by the banks.

271. It would not in our view be desirable for the Inspector General of Banks to become an officer of the Bank of Canada. We suggest that the Bank of Canada and the Inspector General must function independently if each is to perform a proper function. Occasions will inevitably arise where it is helpful for the Inspector General to be able to take an independent and objective position.

SECTION IX

PERSONNEL POLICIES

Recruitment

272. There is an ever-present need for the best type of man and woman available. Banks generally recruit their employees direct from schools and universities. Branch managers keep in touch with local school principals, vocational guidance teachers, and others, looking for capable young people. Bank representatives also visit various universities and colleges to recruit members of graduating classes.

273. Educational requirements are now higher than at any time in the past. Increasing mechanisation is opening the way for more interesting and challenging jobs, requiring more maturity and judgment on the part of the staff. There is a considerable turnover of personnel, particularly among the women as a result of marriage and family responsibilities. All these things combine to bring relatively rapid advancement, and put a premium on high initial educational qualifications and training. With few exceptions banks nowadays want people with at least junior matriculation standing, and are hiring more and more university-trained people.

Salaries

274. Salaries and benefits paid by the banks are fully competitive in the [illegible] market. For the majority of employees the [illegible] is normally less than 40 hours per week, and overtime is paid thereafter at the rate of time and a half. In most banks it is the

practice to grant general year-end bonuses.

Female Staff

275. Approximately 55 % of the staff of the chartered banks today is made up of women. The turn-over due to marriage and other factors is substantial, as already mentioned, and this restricts the numbers who are able to acquire the broad experience needed for senior posts. Nevertheless there are excellent opportunities for advancement for those "career minded" women who do remain on the staff, and many bank women today occupy positions of considerable responsibility.

276. Women hold a number of senior positions in head offices, some being for example members of the inspection staffs. Some branch managers are women, others are in charge of sub-branches, and still others are accountants, assistant accountants, or heads of departments. Opportunities for qualified women in the banks are expected to grow steadily in the future, so that the outlook for them is likely to be increasingly bright in the years ahead.

277. A survey at October 31, 1961 showed the following staff distribution in Canada:-

	Men	Women	Total
Salaried Staff	27,846	36,511	64,357
Wage Earners	3,383	1,768	5,151
	31,299	38,279	69,508

Training and Promotion

278. Almost invariably the chartered banks follow the practice of promotion from within, right up to the highest executive levels. Practically the only exceptions are for personnel having specialised professional training, for example in law, accounting, or economics, and internal promotion is followed wherever possible even in these fields. Officers at all levels are expected to be on the lookout for able individuals who are capable of added responsibility and training, and such people are given every possible opportunity to broaden their experience.

279. Formerly it was customary to train bank staff entirely within the branch, supplemented only by inter-branch transfers for the sake of wider experience. These methods are still used, but it is no longer possible to rely on them entirely. The demands of modern procedures and the need for trained personnel to staff rapidly expanding operations are too great to be met in this time-consuming way. New staff members now usually get a period of intensive schooling in bank procedures at or soon after recruitment. Later they may be given additional training courses to prepare them for increased responsibilities right up to the level of branch management as they receive promotion or are being prepared for promotion. A new employee with advanced educational standing is likely to get special training in the form of rotation to a variety of duties in a relatively short period of time, and to move quickly to a position of responsibility.

280. The employees of all banks are encouraged to participate in the Fellows Course in Banking, which is offered through arrangements between The Canadian Bankers' Association and Queen's University, Kingston, Ontario; successful candidates generally have their tuition fees refunded and also receive a cash award. In some cases officers are selected to attend business administration courses at certain universities, the tuition fees and expenses being paid by their employers. Most banks maintain libraries for the use of their employees.

281. The selection of branch managers is based on performance. Subsequent training normally includes transfers to other branches in order to provide a variety of banking experience. There may also be included a period of credit or inspection work at head office or at a regional administrative office. Promotion is on merit, and normally evolves through successive transfers to branches entailing greater and greater responsibilities.

282. Intermediate and senior posts at head office and at regional administrative offices are filled in essentially the same way. In part this is accomplished automatically through the process of rotating branch personnel as part of normal training procedures, in part by the selection of those with particular aptitudes for specialized posts in regional and head offices. In either case promotion is on the basis of merit.

Pensions and Other Benefits

283. The chartered banks offer various employee

benefits, at least equivalent to those offered by other enlightened employers. Indeed, this is a field in which the banks have done much pioneering over the years. All banks operate retirement plans which make adequate provision for all long-service employees, male and female, and for those unfortunate enough to become incapacitated for further duty. Sick leave provision, Group Life Insurance and Group Health Plans are all on an unusually broad and generous scale.

SECTION X

BANK MECHANIZATION

Meeting the Demands for Service

284. Two major forces have dominated Canadian banking in the post-war period; the increasing use of banking services, and the competitive drive for greater efficiency in banking operations. Between 1945 and 1961 Gross National Product more than tripled, but bank clearings quadrupled. In 1961 the number of deposit accounts increased by 568,000 -- an average of 2,370 every banking day. Cheques cashed (debits) in the fifty-two clearing house centres rose about $25 billion over 1960, to approximately $300 billion. In a typical month some 57,800,000 debit entries were made to deposit accounts, compared to 53,200,000 in 1960.

285. Under the pressure of increasing activity the number of bank branches rose to 5,225 at the end of 1961, an increase of 174 in the year and 2,119 since 1945; bank employment reached 68,128 at the end of the respective fiscal years in 1961, compared with 66,796 a year earlier and 32,337 in 1945. Up-to-the-minute manually operated mechanical aids have been installed to assist the staff. In large centres the required sorting, listing, balancing, distributing, and other processes involved in the clearing of cheques are already a 24-hour operation involving batteries of manually-operated machines each capable of handling one thousand items or more an hour. Nevertheless these methods have serious limitations in giving the customers the prompt

and accurate service that is appropriate to today's high-speed communications. In spite of continually increasing staff it is becoming more difficult to keep up with the volume of work and to maintain the necessary degree of accuracy by existing methods.

286. The next step in the continuous drive of the chartered banks to maintain high standards of service to their customers is the use of electronic equipment. This will assist in the rapid and accurate processing of the continually growing volume of transactions. It will relieve personnel of the bulk of the monotonous routine work, and free them for the multitude of more interesting and challenging jobs that require human judgment and cannot be done by machine.

Mechanized Cheque-Sorting

287. In working towards the introduction of electronic equipment, the emphasis so far has been on machines to "read" and sort cheques. For the past several years a special committee of The Canadian Bankers' Association has been studying various methods and systems. A wide variety of "languages" for automatic cheque-sorting was considered -- punched-card systems, optical scanning, fluorescent ink, magnetic ink in code patterns, to give a few examples. After careful study the banks have agreed on the "Magnetic Ink Character Recognition" method, which has also been adopted by American and British banks. One reason for this choice is its readability; it can be read electronically through over-stamping, pencil and ink [illegible]ks, oils, greases, carbon smudges, opaque tapes, etc.

It is also extremely durable.

288. The banks have agreed in addition that, if maximum usefulness is to be achieved from electronic cheque-handling, there should be standards set for the size of cheques. They have adopted the same type-font as American and British banks (technically known as E-13B), and have agreed on the arrangement and the location of the message that the machines will read.

289. The cheque-reading machines will be worth while only at high-volume points such as main branches in larger clearing centres and other large branches. Most of the physical handling of items for clearing to other banks or branches is done within the individual bank, not in the clearing house itself, hence it is not essential for all chartered banks to inaugurate automatic cheque-sorting simultaneously. Nevertheless the maximum benefits will only be achieved when all are making use of the new procedure.

290. After electronic cheque-sorting is in full operation, it will be logical to tie it in with electronic bookkeeping. However, that is still some time in the future. In any case the introduction of electronic equipment is merely one more step in the evolution of banking in Canada which has been going on over the years. It will be necessary in order to maintain the high standards of service, speed, and efficiency that Canadians have come to expect from their banking system.

Other Countries

291. In other countries the order in which

electronic procedures have been introduced has tended to be the reverse of that in Canada -- they have generally been applied to bookkeeping first and to cheque-handling second.

292. In the U.S.A. a number of banks began experimenting several years ago with the use of computers for handling various types of records. Some have now been successfully using them for some time; this includes the system used in California by the Bank of America, which is of particular interest because branch banking in that state is parallel to Canadian practice. British experience is of interest for the same reason; there the first computer was ordered in August 1959, without waiting for the perfection of mechanical cheque-handling procedures; the installation was designed to be fed by data derived from manual processes. A number of machines are available, differing considerably in detail, but they are all general-purpose computers taken from production lines rather than specialized machines designed for banking operations.

293. Many of the larger banks in the U.S.A. have a sufficient volume of business in a single office to justify the cost of a computer, but some employ one for central bookkeeping on behalf of a number of branches. A number of data processing centres are now springing up to provide smaller banks with similar facilities on a fee basis; some are run by large banks, others by computer manufacturers. In Britain a few of the larger bank branches also have enough volume to support a computer for their own work alone. In other cases however

centralized bookkeeping is used for a number of branches, with entries transferred between the branches and the centre by telecommunications.

294. The mechanical handling of cheques -- reading, sorting, and listing -- is already widespread in the U.S.A. A rapidly increasing portion of all cheques handled by the clearing service of the Federal Reserve Banks is in the new coded form. In Britain experiments with a cheque-sorter using the E-13B type-font had been begun by one bank in the spring of 1960, eight months before the decision to standardize on that system, and equipment of this type is now being introduced.

SECTION XI

DIRECTORS

295. At the close of 1961 the chartered banks had a total of 253 directors. As might be expected these directors have business activities encompassing the entire field of Canadian industry and commerce and have a wide knowledge of conditions in all parts of the country.

296. Directors are elected by the shareholders at their annual meetings with interim appointments made by the boards to fill vacancies which occur during the year. The usual practice at the annual meetings is for the shareholders to propose a slate of existing directors plus the names of other individuals who it is felt would make valuable additions.

297. In choosing a bank director there are many desirable qualities to be sought. The candidate should, of course, have sound judgment and undoubted integrity and be a success in his chosen field, for a director's name must add to the public's confidence in the bank. He should also have broad business experience, usually including an intimate understanding of a particular industry, because the bank's activities are diverse, entering into almost all fields of endeavour in the economy. Not the least of the qualities sought in a director is his ability to attract new and desirable business and to assist in retaining the goodwill of existing customers.

298. Bank boards generally meet weekly or

bi-weekly. Some of the banks follow the practice of holding occasional meetings of their directors at points other than the city where their chief executive office is located. In addition, there are often local committees of directors in various provinces and these local committees meet from time to time, as frequently as weekly, to discuss regional problems and to make recommendations in respect to the local operations of their bank.

299. In their deliberations the directors attempt to ensure that the bank follows sound policies. The board does not usually initiate policy -- but no major policy decisions are made without the approval of the directors. More specifically, the typical board of directors authorizes the larger loans, appoints the chief executive officers of the bank and defines their duties, reviews branch inspection reports and ensures that full audits are carried out, approves dividend, capital and reserve policies and authorizes branch extension plans and other matters of major concern to the bank.

300. It is sometimes suggested that bank directors are in a position to steer bank credit to their own advantage and to the disadvantage of competitors. The duties and responsibilities of directors are set out in the Bank Act. Section 75 (3) provides:

> A director of the bank shall not be present or vote at a meeting of the board during the time at the meeting when a loan or advance to himself or a firm of which he is a member or a

corporation of which he is a director is under consideration, unless the loan or advance is to a corporation controlled by the bank, all the issued capital stock of which, except the qualifying shares of directors, is owned by the bank.

301. In addition, loans to firms with which a bank director is asociated are subject to regulations which do not apply in other cases. For instance, s. 75 (2) (f) provides that a bank may not, directly or indirectly lend money or make advances in a principal amount exceeding five per cent of its paid-up capital to a director of the bank or to any firm or corporation of which a director or the general manager of the bank is a member or shareholder without the consent of two-thirds of the directors present at a regular meeting of the board or a meeting of the board specially called for the purpose.

302. Section 21 of the Bank Act provides the following in respect to qualifications of bank directors:

(1) A person is not eligible to be a director unless he holds stock of the bank as the absolute and sole owner thereof in his individual right and not as trustee or in the right of another, on which not less than .

(a) three thousand dollars, or such greater amount as the by-laws require, have been paid up, when the paid-up capital stock of the bank is one million dollars or less,

(b) four thousand dollars, or such greater amount as the by-laws require, have been paid up, when the paid-up capital stock of the bank is over one million dollars and does not exceed three million dollars, or

(c) five thousand dollars, or such greater amount as the by-laws require, have been paid up, when the paid-up capital stock of the bank exceeds three million dollars;

except that in the case of not more than one-quarter of the number of directors the minimum requirements of subscriptions to stock in paragraphs (a), (b) and (c) shall be reduced to fifteen hundred dollars, two thousand dollars, and twenty-five hundred dollars respectively.

(2) A majority of the directors shall be subjects of Her Majesty ordinarily resident in Canada.

(3) The election or appointment of any person as a director is void if the composition of the board of directors would as a result thereof fail to comply with subsection (2).

(4) A person is not eligible to be elected or appointed a director after the first day of July, 1959, if he has reached the age of seventy-five years.

SECTION XII

REVENUES, EXPENSES, NET EARNINGS, CAPITALIZATION, AND INNER RESERVES

Revenues of the Chartered Banks

303. The chartered banks' revenues are derived principally from two main sources: from interest on the use of their financial assets - loans, securities, etc. - and from charges made to customers for services rendered.

304. It will be seen from Tables I and II, which trace the growth of bank earnings in the post-war years, that total gross revenues have increased over five-fold since 1945 and, in addition, there have been significant changes in the relative importance of the major sources of earnings. In the following paragraphs occasional reference is made to comparable earnings and expense experience in the U.S. banks. No similar information is available for U.K. banks either individually or in total.

305. Interest and discount on loans, which have increased nine times in the post-war period, accounted for 61% of total bank operating earnings in 1961 compared with 35% in 1945. The main reason for this shift in the source of bank earnings is to be found in the changing pattern of asset distribution. At the end of the war 72.2% of the chartered banks' earning assets were invested in securities, principally Government of Canada bonds used to finance the war effort, while loans accounted for only 27.8% of such assets. By 1961

however this distribution had been reversed and loans accounted for 64.3% of earning assets while securities made up only 35.7%.

306. As shown in Table III, the average rate of return on loans has also increased over the post-war period from 4.13% in 1945 to a high of 5.88% in 1960; it was 5.86% in 1961. Part of the increase in loan revenue is therefore the result of changes in interest rates. The prime lending rate remained at 4-1/2% during the post-war period to April 23, 1956, when it was raised to 5%. Since then it has varied between 5% and 5-3/4%. The last change occurred on June 1st, 1961, when it was reduced to 5 1/2%, where it remains at time of writing.

307. While the rate of return on total loans has tended to follow changes in the prime lending rate, the total revenue from loans does not move directly with interest rates since increases in the prime rate are usually accompanied by, and are indicative of, restrictive lending policies in response to central bank action. Consequently, the growth of bank loans, discussed elsewhere in this submission, naturally has an important bearing on the growth of revenue from this source.

308. Interest, dividends and trading profits in securities were 2-1/2 times larger in 1961 than in 1945 compared with the nine-fold increase in interest on loans. Income from securities has, as a r[illegible] creased sharply as a per cent of total revenue. This trend is, of course, related to the declining trend of

security holdings already mentioned.

309. The average rate of return on securities has been increasing over the post-war period in keeping with the rising trend in interest rates generally. In 1945 the banks earned an average of 1.87% on their securities, including trading profits, compared with 3.94% in 1960 and 3.81% in 1961.

310. Earnings from securities are held down to some extent by the nature of the bank's operations. When loan demand is strong the banks have traditionally shifted from securities to loans to meet this demand and their customers have come to expect such continued support. But when loan demand is high, interest rates are also high and bond prices are low. Thus as fully discussed elsewhere in this brief the banks often find themselves selling securities at the bottom of the market and buying at the top, when loan demand is slack and interest rates are relatively low.

311. The chartered banks' revenue from charges to customers for banking services consists principally of four types of charges:

a) Service charges on deposit accounts

b) Charges connected with foreign exchange transactions and foreign collections

c) Domestic exchange and commissions on cheques and drafts.

d) Charges for safety deposit boxes and safekeeping of securities and other valuables.

TABLE I

CANADIAN CHARTERED BANKS
EARNINGS AND EXPENSES

	1945	1950	1955	1960	1961
	($ Millions)				
Current Operating Earnings					
Interest & Discount on Loans	60	125	236	526	541
Interest, Dividends & Trading Profits on Securities	71	101	128	182	197
Exchange, Commission, Service Charges and other current Operating Earnings	41	56	89	135	143
Total Current Operating Earnings	172	282	454	842	880
Current Operating Expenses					
Interest on Deposits	35	58	105	271	291
Remuneration to Employees	56	102	153	230	244
Contributions to Pension Funds	4	12	14	13	13
Provision for Depreciation of Premises	3	7	10	18	20
Other Current Operating Expenses	27	45	70	114	123
Total Current Operating Expenses	124	220	352	646	690
Net Current Operating Earnings	48	62	102	197	190
Provision for Income Taxes	13	16	37	91	102
Dividends Paid	10	16	26	54	58
Net Available for Losses or for General Contingencies	25	30	38	52	30
Net Capital Profits (Loss)	-	-	(1)	4	2

Source: Canada Gazette. Compiled from returns made pursuant to Section 106 of the Bank Act.

TABLE II

CANADIAN CHARTERED BANKS
EARNINGS AND EXPENSES

	1945	1950	1955	1960	1961
	(Percentage of Total Operating Earnings)				
Current Operating Earnings					
Interest & Discount on Loans	35	44	52	62	61
Interest, Dividends, & Trading Profits on Securities	41	36	28	22	22
Exchange, Commission, Service Charges & Other Current Operating Earnings	24	20	20	16	16
Total Current Operating Earnings	100	100	100	100	100
Current Operating Expenses					
Interest on Deposits	20	21	23	32	33
Remuneration to Employees	33	36	34	27	28
Contributions to Pension Funds	2	4	3	2	1
Provision for Depreciation of Premises	2	2	2	2	2
Other Current Operating Expenses	16	16	15	14	14
Total Current Operating Expenses	73	78	78	77	78
Net Current Operating Earnings	27	22	22	23	22
Provision for Income Taxes	7	6	8	11	12
Dividends Paid	6	6	6	6	7
Net Available for Losses & for General Contingencies	15	10	9	6	3

TABLE III
EARNINGS RATIOS
CANADIAN CHARTERED BANKS AND U.S. COMMERCIAL BANKS

		1945 %	1950 %	1955 %	1960 %	1961 %
Percentage of Total Assets*						
Total current earnings	- Canada	2.59	3.16	3.83	5.17	5.04
	U.S.	1.80	2.51	3.07	4.39	N.A.
Net Current earnings	- Canada	0.70	0.66	0.86	1.21	1.09
	U.S.	0.75	0.97	1.11	1.58	N.A.
Net earnings available for dividends and losses	- Canada	0.53	0.50	0.54	0.65	0.50
	U.S.	0.55	0.70	0.72	1.02	N.A.
Percentage of Total Capital Accounts*						
Net current earnings	- Canada	15.31	16.69	18.64	20.53	18.54
	U.S.	13.11	13.97	15.40	19.53	N.A
Net earnings available for dividends and losses	- Canada	11.48	12.71	11.93	11.08	8.59
	U.S.	9.53	10.08	9.97	12.60	N.A.
Dividends declared	- Canada	3.15	4.41	4.81	5.64	5.64
	U.S.	3.29	3.55	3.87	4.17	N.A.
Rates of Return on Securities including Trading Profits	- Canada	1.87	2.31	2.69	3.94	3.81
	U.S.	1.61	1.73	1.90	3.18	N.A.
Rates of Return on Loans	- Canada	4.13	4.49	4.78	5.88	5.36
	U.S.	3.01	4.27	4.78	5.86	N.A.

* Figures for Assets and Capital Accounts are:
a) in Canada - average of month ends for fiscal year.
b) U.S. average of figures reported on call dates at the beginning, middle and end of each year.

Sources: Canada - Canada Gazette
U.S.A. - Federal Reserve Bulletin,

312. While revenues from these sources increased some 3-1/2 times between 1945 and 1961, they have declined from almost 24% of total revenues in 1945 to 16% in 1961.

313. Service charges on deposit accounts now represent some 28% of total miscellaneous earnings in contrast to 14% in 1950. This reflects increases in both rates charged and in deposit velocity. A comprehensive cost analysis was conducted in 1961 in order to determine the reasonableness of present service charges. It was found that in general costs are now above the present customary scale of bank service charges.

314. It is apparent that service charge rates have not been sensitive to rising costs, and the minimum rates have been revised upward at intervals only when it became obvious that they were much out of line with costs. Competition for deposit customers between the banks themselves and with the non-bank financial institutions results in the minimums seldom being exceeded.

315. Rates on other standard bank services have been even less frequently increased. There have been no changes in exchange rates on out-of-town cheques since the Bank Act revision of 1900 and apart from increases in the charges applicable to small items the same has held true for basic collection charges. Safety deposit box charges have remained unchanged since 1949, money order commissions since 1948. Commissions on foreign exchange services have increased in the past decade but only slightly. Consequently, while revenue

from these sources has varied in volume, it has not kept pace with rising costs and this, coupled with sharp increases in earning assets, has resulted in its decline as a proportion of total revenue.

316. In general it would seem preferable for service charges to match the cost of services rendered insofar as practical. If, for instance, service charges are waived in view of the large borrowings of a customer this really results in an effective charge for interest below the going rate. Free services in line with free balances kept seems equitable if this results in the banks paying for funds by way of service provided. But if each service does not bear its own cost then, the effect is that one class of customer must subsidize another.

Trends in U.S. Commercial Bank Earnings

317. Tables IV and V show earnings statistics for U.S. commercial banks. It will be seen that their earnings pattern is very similar to that in Canada. There has been the same shift in the major source of earnings from securities to loans in the post-war period, and the relative proportion of revenue derived from loans and from securities is similar in both countries.

318. It is interesting to note that the rate of return on loans in the two countries has been roughly the same as shown in Table III; in this connection it must not be overlooked that it is a common practice in the U.S.A. to require compensating deposit balances against loans, which raises the effective cost of borrowing to a level substantially above that indicated

by the nominal interest rate. The rate of return on securities earned by the Canadian banks has been consistently higher than that earned by U.S. commercial banks because bond yields in Canada have usually been higher than those in the United States. While in 1945 Canadian banks were able to earn a greater relative share of total earnings from service charges, the Canadian share has fallen some 8 percentage points in the intervening years in comparison with a decline of only 3 points in the U.S.A.

Expenses of the Chartered Banks

319. The current operating expenses of the chartered banks rose 5-1/2 times in the post-war period from $124 million in 1945 to just over $690 million in 1961. As will be seen from Table I, while all major items of expenses have increased, there has been a considerable change in the relative importance of different items.

320. In 1945 interest on deposits amounted to $34.8 million representing 20% of total operating earnings; by 1961 interest amounted to $290.8 million, or 33% of the total. Interest paid on deposits is now the largest single item of bank expenses.

321. This growth is attributable to substantial increases in both the rates of interest paid on deposits and the total amount of interest-bearing deposits. Because Canadian statistics do not segregate interest-bearing deposits - part of government, foreign and other bank deposits, for example, are interest-bearing - it is not possible to calculate an actual rate paid. However,

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TABLE IV

U.S. COMMERCIAL BANKS
EARNINGS AND EXPENSES

	[illegible]	[illegible]	1955	1960	% 1960/1945
	---------($ Millions)				----------
Current Operating Earnings					
Interest & Discount on Loans	706	1976	3626	6699	946
Interest, Dividends & Trading Profits on Securities	1434	1293	15 20	2478	173
Exchange, Commission, Service Charges and other Current Operating Earnings	474	714	1067	1656	349
Total Current Operating Earnings	2616	3983	6213	10,833	414
Current Operating Expenses					
Interest on Deposits	233	343	676	1572	603
Remuneration to Employees	641	1202	1896	2798	405
Provision for depreciation	40	59	108	212	530
Other Current Operating Expenses	559	841	1278	2051	367
Total Current Operating Expenses	1523	2445	3960	6933	455
Net Current Operating Earnings	1093	1538	2253	3900	357
Provisions for Income Taxes	299	428	794	1384	463
Dividends	274	39[illegible]	566	832	304
Net Available for Losses or for General Contingencies	520	719	893	1684	324

Source: Federal Reserve Bulletin.

TABLE V

U.S. COMMERCIAL BANKS
EARNINGS AND EXPENSES

	1945	1950	1955	1960
	(Percentage of Total Current Earnings)			
Current Operating Earnings				
Interest and Discount on Loans	27	50	58	62
Interest, Dividends and Trading Profits on Securities	55	32	24	23
Exchange, Commission, Service Charges and other Current Operating Earnings	18	18	17	15
Total Current Operating Earnings	100	100	100	100
Current Operating Expenses				
Interest on Deposits	9	9	11	17
Remuneration to Employees	26	30	30	26
Provision for Depreciation	2	1	2	2
Other Current Operating Expenses	21	21	21	19
Total Current Operating Expenses	58	61	64	64
Net Current Operating Earnings	42	39	36	36
Provision for Income Taxes	11	11	13	13
Dividends	10	10	9	8
Net Available for Losses or for General Contingencies	20	18	14	16

the standard rate on personal savings deposits which was 1-1/2% in 1945 has risen to 2-3/4%. The rates on other notice deposits have increased even more. In 1945 the rate paid for other notice deposits was 1/2%; today it runs up to 3-3/4% for fixed-term deposits, and ordinary corporate notice deposits obtain 2-3/4%.

322. It is apparent that the rate of interest which the banks pay on deposits cannot for long increase faster than the rate of interest earned by the banks on their loans. In 1945 there was a spread of 3% between the standard rate of interest paid on personal savings deposits of 1-1/2% and the prime lending rate of 4-1/2%; since then this spread has been reduced to 2-3/4%. At the same time with the rate of interest paid on the growing volume of other notice deposits increasing from 1/2% to as much as 3-3/4% for deposit receipts, and even higher in the case of term notes with maturities over one year, the spread has been reduced even more.

323. The large post-war increase in Canadian notice deposits has been discussed elsewhere in this submission. However in addition to increased interest expense for Canadian deposits there has been a rapid growth in recent years in interest-bearing deposits in foreign currencies. The rate of interest paid on these deposits is sometimes higher than the amount paid on Canadian deposits, in line with the rate of interest at which the funds can be employed in international markets.

324. The second largest item of bank expense is salaries and wages. In total these items were 4-1/2 times larger in 1961 than in 1945, rising to $244 million

from \$56 million. In 1961 salaries represented 61% of total operating expenses, exclusive of interest paid.

325. The contributions by the banks to their employees' pension funds have risen from year to year as the number of employees and the amount of salaries have increased. The banks have also made lump-sum payments to these funds as the actuarial needs of the funds have required. In total, contributions by the banks to their pension funds rose from \$3.8 million in 1945 to \$13.3 million in 1961.

326. The proportion of the banks' operating expenses set aside for depreciation has remained fairly constant during the post-war period. The total amount involved, however, has increased substantially from \$3.2 million in 1945 to \$19.6 million in 1961. This increase has resulted in the main from the renovation and expansion of older branches and to a lesser extent from the construction of new ones.

327. Of the other current operating expenses, comprising 14% of total earnings in 1961, the more important items are for outlays for advertising and publications, communication, property, stationery, miscellaneous taxes and travelling. Of these, property costs are by far the largest, accounting for 40% of such sundry expenses.

Trends in U.S. Commercial Bank Expense

328. U.S. experience on costs has been broadly similar to Canada's. Interest expense has increased noticeably in relation to earnings in both countries. However, the proportion of total expense paid as interest

is much lower in the United States than in Canada. This is because, as noted earlier in this brief, the proportion of interest-bearing notice deposits to total deposits is much lower in U.S. commercial banks than in the Canadian chartered banks. Other current operating expenses are proportionately greater in the U.S. than in Canada, possibly because of the economies of Canada's branch system.

Net Current Operating Earnings

329. In addition to the factors discussed above which have affected the growth of earnings and expenses, two other trends have affected net earnings. First, the shift from lower-yielding securities to higher-yielding loans has produced an increase in the return on total bank assets. As will be seen from Table III, the ratio of earnings to total assets has increased from 2.60% in 1945 to 5.17% in 1960 and was 5.04% in 1961.

330. At the same time, however, the distribution of the banks' liabilities has changed. There has been a relative shift from non-interest-bearing deposits to interest-bearing deposits. Canadian notice deposits increased from some 47% of total Canadian deposits in 1945 to 64% in 1961. In addition, as mentioned earlier, there has been a substantial increase in foreign interest-bearing deposits. Thus, the banks have been faced with a trend towards relatively higher costs for their deposits which has offset part of the gains from the higher return on assets.

331. Nevertheless, net operating profits before provision for losses and income taxes have increased

from $46.7 million in 1945 to $189.9 million in 1961 a four-fold gain and expressed as a percentage of total assets have increased from 0.707% at the end of the war to 1.087% in 1961. This net rate of return on assets however is below that earned by United States commercial banks which amounted to 1.11% in 1955 and 1.58% in 1960.

332. Furthermore, it appears unlikely that the chartered banks will be able to increase the net return on total assets much above present levels. The post-war shift from low-yielding securities to loans seems to be approaching an end with the ratio of risk assets to deposits near 70%. At the same time the shift from non-interest-bearing deposits has shown no sign of slowing down.

333. It is apparent from Tables II and V that net operating earnings represent a much higher precentage of total earnings in the United States than in Canada, with the interest paid on deposits the chief reason for the difference. Income taxes were 13% of total 1960 earnings in the U.S. and 11% in Canada while dividends were 8% in the U.S.A. and 6% in Canada. The most marked difference in the two countries was that the proportion of retained earnings including all provisions for losses or contingencies were 16% of total operating earnings in the United States as compared to 6% in Canada.

334. In the United States, the ratio of capital to total assets is higher than in Canada. In spite of this, Table III shows that net current earnings as a percentage of capital funds have been only slightly lower in the U.S.

335. The above paragraphs have described total earnings and expenses of the banks regardless of where they were earned or incurred. It has only been in the last two years, however, that figures on the allocation of earnings as between domestic and foreign business have been reported to the Inspector General of Banks along with the required Schedule Q return. While these new figures may not completely allocate earnings and expenses between domestic and foreign business - depreciation, for example, is charged in toto against domestic earnings - some indication of the importance of foreign business may be gained from the fact that these figures show that foreign net earnings have amounted to 12% of total net earnings in both 1960 and 1961.

Bank Capital

336. Capital funds of Canadian banks consist of paid-up capital rest account and undivided profits. The three categories together make up the total of "share-holder's equity".

337. It is generally accepted that one of the primary uses of capital for banks as for other types of business enterprises, is the provision of the physical means of doing business, including, among other things, buildings, equipment, furniture and the "tools of the trade". For this reason, "bank premises" accounts have been deducted from "shareholders' equity" in certain ratios and tables as well as in the discussion of trends and adequacy of capital.

338. Another major purpose of capital is to ensure

the protection of depositors' funds and the continuance of the bank as a going concern. From the viewpoint of depositors this assurance means that confidence in the bank is maintained at all times, since it is considered there is enough capital in the banking institution to absorb losses that may reasonably be expected to occur in the future. The amount of capital required for this purpose will, of course, be influenced by the amount of the banks' contingency reserves. In Canada, the nature of chartered banks assets has changed over the years. The banks now hold a large proportion of government bonds and loans guaranteed in some degree by the Federal Government. Consequently, the decline of the capital-to-deposit ratio in Canada and in other major countries has not been cause for alarm.

339. A further point is that most Canadian chartered banks are international in scope, with operations in a number of countries. Many of these countries require banks to maintain capital within the countries concerned. In other countries capital is necessary for the same reasons as prevail in Canada even if no statutory obligations are laid down.

340. The trend of capital in relation to deposits and risk assets is shown in Tables VI and VII. While shareholders' equity has increased about four-fold since 1925, deposits have increased more than six times during the same period. The ratio of capital to deposits was 10.7% in 1925, it increased slightly during the early thirties, then began a slow decline to a low point of 4.0% in 1952. In subsequent years, new issues

of capital raised the ratio; at the end of 1961 it stood at 6.1%. The ratio of capital excluding bank premises to deposits showed a similar pattern.

341. The decline in the ratio of bank capital to deposits from the 1920's to the early 1950's, and subsequent increase, have also occurred in other countries. Furthermore, in the United States the ratio for commercial banks declined from 8.2% in 1930 to 7.9% in 1950 and has since risen to approximately 9.7% in 1961. In the United Kingdom the ratio for leading banks has moved from 7.6% in 1930 to 2.6% in 1950 and approximately 4.0% in 1961. In all three countries the greater part of the decline reflects, in the main, the results of monetary expansion.

342. The decline in the relative size of capital funds has given rise to discussions concerning the adequacy of bank capital. Views of what is "adequate" capital have varied from time to time and from country to country as circumstances have changed.

343. Nevertheless, the size of a bank's capital remains for many depositors a measure of the bank's strength. This is undoubtedly true in an even greater degree in the field of international banking where the large and increasing share of business which Canadian banks enjoy is in no small part attributable to their capital strength as revealed in published statements.

TABLE VI

CANADIAN CHARTERED BANKS

RATIO OF SHAREHOLDERS' EQUITY TO DEPOSITS

Dec. 31st	Deposits** ($ Millions)	Shareholders' Equity* ($ Millions)	Shareholders' Equity* %	Shareholders' Equity* Less Bank Premises ($ Millions)	Shareholders' Equity* Less Bank Premises %
1925	2,366	254	10.7	173	7.3
1926	2,410	257	10.6	179	7.4
1927	2,653	271	10.2	195	7.4
1928	2,816	275	9.8	198	7.0
1929	2,820	318	11.3	238	8.4
1930	2,565	322	12.6	237	9.2
1931	2,426	322	13.3	235	9.7
1932	2,306	316	13.7	229	9.9
1933	2,294	286	12.5	201	8.8
1934	2,405	287	11.9	201	8.4
1935	2,609	287	11.0	202	7.7
1936	2,773	289	10.4	205	7.4
1937	2,819	291	10.3	210	7.4
1938	2,986	292	9.8	211	7.1
1939	3,378	294	8.7	214	6.3
1940	3,277	295	9.0	217	6.6
1941	3,634	296	8.1	221	6.1
1942	4,287	297	6.9	224	5.2
1943	5,149	297	5.8	227	4.4
1944	5,997	301	5.0	236	3.9
1945	6,884	299	4.3	234	3.4
1946	7,226	333	4.6	268	3.7
1947	7,406	340	4.6	269	3.6
1948	8,002	346	4.3	268	3.3
1949	8,177	353	4.3	266	3.3
1950	8,867	361	4.1	255	2.9
1951	9,003	375	4.2	255	2.8
1952	9,570	381	4.0	256	2.7
1953	10,140	419	4.1	309	3.0
1954	10,713	521	4.9	406	3.8
1955	11,904	567	4.8	441	3.7
1956	12,531	653	5.2	509	4.1
1957	13,234	732	5.5	573	4.3
1958	14,767	813	5.5	636	4.3
1959	14,651	926	6.3	720	4.9
1960	15,575	1,004	6.4	770	4.9
1961	17,674	1,071	6.1	817	4.6

*Capital, Rest Fund and Undivided Profits.

** Deposits in Canada and elsewhere in Canadian and other currencies.

Source: Canada Gazette.

TABLE VII

CANADIAN CHARTERED BANKS

Dec. 31st	Shareholders' Equity less Bank Premises ($ Millions)	Shareholders' Equity Less Bank Premises as a Percentage of: 1 Total Loans and Securities Other than Canadian Federal Provincial and Municipal Securities %	2 1 Plus Canadian Municipal Securities %	3 2 Plus Provincial Government Securities %	4 3 Plus Canadian Federal Securities with Maturity over two Years %
1925	173	10.3	9.9		
1926	179	9.8	9.5		
1927	195	9.6	9.4		
1928	198	9.0	8.8		
1929	238	10.0	9.9		
1930	237	12.4	12.0		
1931	235	13.6	13.0		
1932	229	15.2	14.3		
1933	201	14.0	N.A.		
1934	201	14.9	14.0		
1935	202	15.5	14.5		
1936	205	16.3	15.0		
1937	210	16.2	15.0		
1938	211	15.8	14.7	11.5	
1939	214	14.6	13.8	11.0	
1940	217	15.2	14.4	11.6	
1941	221	15.0	14.3	11.7	
1942	224	15.3	14.7	12.0	
1943	227	15.4	14.9	12.4	
1944	236	14.6	13.9	11.9	7.6
1945	235	12.3	11.7	10.1	5.4
1946	268	12.8	12.2	10.7	5.8
1947	269	9.7	9.4	8.1	5.0
1948	268	8.9	8.6	7.5	4.7
1949	266	8.6	8.3	7.3	4.6
1950	255	6.9	6.6	6.1	4.2
1951	255	6.4	6.2	5.8	4.0
1952	256	5.6	5.5	5.1	3.8
1953	309	5.8	5.7	5.5	4.1
1954	406	7.5	7.3	7.0	5.0
1955	441	6.7	6.5	6.2	4.8
1956	509	6.7	6.5	6.3	5.5
1957	573	7.[illegible]	6.5	6.6	5.7
1958	636	7.4	7.2	6.9	5.8
1959	720	7.4	7.2	7.0	6.3
1960	770	7.5	7.3	7.1	6.2
1961	817	7.3	7.1	6.9	6.1

Percentages 3 and 4 commence with first year in which Government Return showed the appropriate totals.

Source: Canada Gazette.

TABLE VIII

SELECTED BANKS
RATIO OF SHAREHOLDERS' EQUITY TO DEPOSITS AND PAR VALUE OF SHARES

	World's Largest Banks		Deposits (Millions*)	Share-holders' Equity (Millions*)	Ratio %	Par Value of Common Shares*
			Latest Fiscal Year End			
1	Bank of America, National Trust & Savings Assn., San Francisco		11,475	785	6.84	6.25
2	Chase Manhattan Bank, N.Y.		8,876	718	8.09	12.50
3	First National City Bank, N.Y.		8,372	784	9.36,	20.00
4	Manufacturers Hanover Trust Co., N.Y.		5,521	454	8.22	15.00
5	Barclays Bank Limited, London		£ 1,806	£ 84	4.65	£ 1
6	Midland Bank Limited, London		£ 1,669	£ 70	4.19	£ 1
7	Chemical Bank New York Trust Co.		4,353	430	9.88	12.00
8	The Royal Bank of Canada	($ Can.)	4,502	306	6.80	10.00
9	Morgan Guaranty Trust Company		4,136	571	13.81	25.00
10	Canadian Imperial Bank of Commerce	($ Can.)	4,220	256	6.07	10.00
11	Lloyds Bank Limited		£ 1,402	£ 70	4.99	£ 1
12	Security First National Bank, L.A.		3,662	271	7.40	12.50
13	Bank of Montreal	($ Can.)	3,647	208	5.70	10.00
14	Bankers Trust Company, N.Y.		3,391	310	9.14	10.00
15	Continental Illinois National Bank and Trust Company Chicago		3,313	331	9.99	33.33
16	First National Bank, Chicago		3,142	322	10.25	20.00
17	Westminster Bank Limited, London		£ 1,022	£ 42	4.09	£ 1
18	Deutsche Bank		DM. 11,122	DM. 640	5.75	DM. 100
19	Wells Fargo Bank, Am. Trust Co., S.F.		2,712	201	7.41	10.00
20	National Provincial Bank Ltd., London		£ 947	£ 43	4.54	£ 1
	Other Canadian Banks					
	The Bank of Nova Scotia	($ Can.)	2,120	118	5.57	10.00
	The Toronto-Dominion Bank	"	1,969	113	5.74	10.00
	Banque Canadienne Nationale	"	773	45	5.82	10.00
	La Banque Provinciale du Canada	"	399	19	4.76	10.00
	The Mercantile Bank of Canada	"	102	5	4.90	10.00

* U.S. Dollars unless otherwise indicated.

Sources: Annual Reports.

344. Early bank charters sometimes required a specified ratio of capital to "notes issued" or "total indebtedness". To some extent these provisions regarding capital were really connected with bank liquidity as well as solvency. As pointed out elsewhere liquidity of the banking system in an era of managed money is an entirely separate problem and a much lower capital seems reasonable under current conditions.

345. Supervisory authorities in the United States came to apply a standard ratio of capital to deposits of 10%, but "there appears to be no scientific basis for this particular ratio. It is simply a good round decimal, easy to calculate at a glance." (Roland J. Robinson "The Capital Deposit Ratio in Banking Supervision", Journal of Political Economy, XLIX, February, 1941, p. 41.) More recently it has come to be recognized that any simple capital-deposit ratio can be misleading: "the fundamental question on the adequacy of bank equities must be answered in relation to whether a decline which might take place in the value of the assets of a bank would cause the solvency of the bank to be in jeopardy." (Louis Frohmann, "The Adequacy of Bank Capital", Journal of Finance, October, 1947, p. 24.) As shown in Table VIII the ratio of capital to deposits for the 20 largest banks in the world as at the latest balance sheet date varies widely but the range for Canadian chartered banks is not out of line.

Par Value of Shares

346. The banks at present have some 85,000 shareholders. This is an increase of 50,000 since 1944 when,

in accordance with the Bank Act revision of that year, stocks were split ten for one. It seems to us desirable that widespread ownership of shares in the banks should be encouraged, but the market prices of the various bank stocks have now reached levels that tend to limit wider distribution.

347. Both in the interests of the public and in the interests of the banks themselves, some changes in the statutory $10 par value for bank shares should be considered.

Inner Reserves

348. The chartered banks are permitted to make limited appropriations from current earnings before taxes for the purpose of providing reserves against losses on certain of their loans and securities, and their net long foreign exchange positions. The Bank Act requires that the loans of a bank be stated "less provision for estimated loss" and that all securities other than Canadian Federal and Provincial be stated at "not exceeding market value". To fulfill these requirements the banks deduct the above-mentioned reserves, known as inner reserves, from the total value of loans and eligible investments and show only a net or realizable value for these assets.

349. Prior to 1944 there were no specific statutory requirements with respect to inner reserves but, as was brought out in the Proceedings at The Standing Committee of the House of Commons on Banking and Commerce in that year, the shareholders' auditors and the Minister of Finance through the Inspector-General of Banks had

been responsible for seeing that a bank's assets were neither over-valued nor under-valued. However, in 1944 the Bank Act was amended to charge the Minister of Finance with specific responsibility for determining the amount which, in his opinion, was a reasonable appropriation for a bank to make each year to its inner reserves. Since that time the Minister has issued periodically the Rules by which he makes this determination.

350. Inner reserves, as defined by the above-mentioned Rules, are divided into three categories: tax paid, specific and contingency. Tax paid reserves are those on which all taxes exigible by the Government have been assessed. Specific reserves are provisions allowed for potential losses that are readily discernible at the time; contingency reserves refer to additional provisions for estimated losses which, while not apparent at the time, are, nevertheless, known from experience to exist in any large body of loans and securities.

351. From 1944 to 1954 the Rules issued by the Minister first defined the assets in respect of which contingency reserves were permitted and then specified a percentage to be applied to each class of assets to arrive at the allowable reserve. The reserves so calculated were originally in addition to the specific reserves that a bank was permitted to take in order to reduce the book value of the relative assets to estimated realizable value. In 1955 the Rules were changed so that only the greater of the specific or contingency

reserves on each class of assets was allowed. Again in 1957 permitted reserves were further modified to disallow reserves of any kind on certain classes of assets including Canadian Federal and Canadian Provincial securities, and finally in 1960 the fixed percentage levels for the different classes of assets were replaced by a single, variable percentage that is based on a moving average of a number of years' loss experience for the banking system as a whole.

352. The fact that such provisions are permitted as a deduction from earnings before taxes has given rise to criticism in some quarters. Even though taxes on inner reserves are deferred, it has been contended that the reserves are by now almost permanent, and the resulting permanent tax deferment is equivalent to preferential tax treatment. This is true, of course, of any provision for bad and doubtful debts. Nevertheless, the fact remains that the banks must pay taxes at the current rate on any transfers from contingency and specific reserves unless they are used for the purpose of writing off bad debts.

353. The entire concept of inner reserves was reviewed in considerable detail during the proceedings leading up to both the 1944 and 1954 revisions of the Bank Act. In 1944 the importance of inner reserves as a factor in maintaining the confidence of depositors, while at the same time giving management the freedom of carrying on the lending function effectively was explained by the Minister of Finance when he said in part:

"It will be apparent from what I have said

that the inner reserves of the banks are nothing more or less than the reserves for bad and doubtful debts which the banking business requires. They constitute the first line of defence against losses on loans and losses on investments which may have to be realized in cash on a large scale and on short notice and which by law cannot be valued at more than current market prices. If the public functions of banking are to be performed, if the banks' demand obligations to their millions of depositors are to be met, and if the banks are to provide credit freely for the needs of trade and industry, these reserves must be adequate to absorb the shocks of adverse business conditions or fluctuations in security markets. If inner reserves are inadequate, bank managements will be hesitant to grant credit freely and take the risks that proper service to the public requires. If as a result of inadequate inner reserves, banks have frequently to resort to published rest funds to meet inevitable losses on loans or shrinkage in the value of their investments, public confidence will be impaired -- may be lost altogether. Once confidence is impaired, the need for inner reserves becomes all the greater. As a last resort, the central bank may come to the rescue but reliance on the central bank should not be a steady diet or be any excuse for failure of the chartered banks to

maintain themselves in a sound and strong condition."

354. The lack of disclosure of inner reserves appears to cause some concern in certain directions. While it is conceded that the publication of these amounts could possibly further the interests of shareholders, it is also believed that this would be detrimental to the interests of depositors, and it has long been the practice of Canadian banking to regard their interests as paramount. In this respect the Cohen Committee on company law amendment in the United Kingdom concluded that:

> "In the case of banking companies, the interests of the depositors outweigh the interests of the shareholders and considerations affecting the public interest must be taken into account. The reputation for stability of these companies is a national asset of the first importance to the community in general, and it is not in the public interest to endanger their stability or the confidence they enjoy at home and abroad. History demonstrates the public advantage of their being able to present a reasonably stable position in a time of violent and sudden stress and for this reason, it seems to us desirable that such companies should be permitted to retain a buffer of undisclosed reserves."

355. None of the foregoing is intended to imply that the existence of undisclosed inner reserves acts

to the detriment of the shareholders' interests. Notwithstanding any lack of complete disclosure there are ample safeguards of the position of a Canadian bank shareholder. The provisions of the Bank Act regarding the appointment and responsibilities of the shareholders' auditors as well as the comprehensive supervision afforded by the office of the Inspector General of Banks are as much indicative of the Government's concern with the interests of depositors and shareholders as they are evidence of its general responsibility for the continuing safety and stability of the Canadian banking system. In 1944 the Minister of Finance stressed the importance of this concept when he expressed the opinion that:

> "..........it is a responsibility of the shareholders' auditors and of the Inspector General of Banks to see not only that inner reserves are built up to the level of adequacy but also that they do not exceed this level. Look for a moment at the position of the shareholders' auditors. If they allow over-valuation of the bank's assets, they may be jeopardizing the entire investment made by the shareholders of the bank. On the other hand, if they allow real under-valuation of the banks' assets, they are not allowing the shareholders to obtain as fair a return on their investment as the bank's earnings justify. Neither of these errors is justifiable. A proper sense of their trusteeship to the shareholders whom they represent requires the auditors to exercise the soundest

judgment they possess in certifying that the assets of the bank are truly valued -- that is to say, neither over-valued nor under-valued."

356. Under the present method of determination, the allowable percentage for the total of specific and contingency reserves is based on a moving average loss experience for the past 25 years for the banking system as a whole. However, by definition, reserves are a cushion against the contingencies of the future rather than those of the past and any allowance based solely on historical experience may often be inappropriate to current circumstances. It follows that if a certain percentage for inner reserves is considered adequate for a given year the actual loss experience for that year is not necessarily an accurate guide fot the determination of this allowable percentage in future years. Even though losses themselves are not discernible when loans are granted, accepted accounting practice dictates that provision should be made for unidentifiable but potential losses at that time, and the banks are faced with the need for making appropriations to their inner reserves in times of prosperity with the full knowledge that these reserves will be drawn against in periods of high loss experience.

357. The application of the existing formula means that each year in the present cycle the banks are replacing low average assets and relatively high loss experience by high average assets and low loss experience. Consequently the current formùla for determining the total of specific and contingency reserves produces a

somewhat anomalous result. A number of consecutively good years will push the allowable percentage down at perhaps the very time that reserves should be built up. Business has been at a relatively high level with comparatively low losses and no major down-turns for more than twenty years -- certainly the longest sustained period of high activity in modern history. When the formula is calculated next year the twenty-five year average will contain only two years of the thirties and two of the best at that, 1938 and 1939.

358. The allowable percentage for the reserve formula has been reduced substantially over the past few years. If this allowable level continues to decline in the face of sustained low loss experience, the point may be reached where the low level of reserves begins to affect the banks' day-to-day operating decisions in the extension of credit. Inadequacy of contingency reserves can hardly help but colour the viewpoint of the banks in formulating their credit policy. With reserves at a minimum following a period of prosperity they might well be compelled not only to hesitate in a subsequent recession to make the very type of loans that would be helpful in stimulating recovery but also to be less lenient in carrying a borrower through his own difficult periods.

359. It is the opinion of the banks that the continued application of the present formula may result in an allowable percentage so low as to defeat the purpose of inner reserves, and it may be that the present permitted level is already down to a point below which

it would be undesirable to go. For this reason, the adoption of the principle of establishing a "floor" below which the formula would be inoperative is recommended. While the decision of where this "floor" should be established is a matter of judgment and not susceptible of accurate determination, it is the considered view of the banks that it should be established not below the permitted level for the current year so that they may be in a position to take normal credit risks in all kinds of financial weather.

PART THREE

FINANCIAL COMPETITION AND CONTROL

SECTION I

COMPETITION AMONG BANKS

Rates and Charges

360. The chartered banks are in keen competition with other lenders and depositories in respect of most of the business they do. However, none of these other institutions offers a full range of banking services. The banks play a key role in the operation of the payments mechanism, for example, including the clearing of cheques and drafts locally, between different points in Canada, and internationally; this role attracts substantial deposit balances regardless of the interest rate structure, though it also involves costs, not all of which are directly recoverable from the beneficiaries.

361. In general bank interest rates on deposits and on loans must conform fairly closely to the over-all structure of comparable interest rates, but there is some scope for variation because bank loan and deposit facilities are associated with other banking services that must be paid for in one way or another.

362. Among the chartered banks themselves however competition must take a different form. The various banks offer a virtually identical range of services to the public, and no one bank has a monopoly of staff and facilities capable of performing these services in a

courteous and efficient manner. It is obvious that any bank will have to meet the best rate offered by other banks in any major category of service, otherwise it will lose virtually all of its business in that line; there is therefore little scope for differences between banks in respect of interest rates or charges. For example, if the interest rate structure is considered unbalanced, there may be some question as to whether it is lending rates or deposit rates that should be changed. Almost invariably the bank which is willing to operate at the rate most favourable to its customers sets the pattern for all the others; no one bank or group of banks could long continue to exact terms less favourable than any one bank or a minority of banks was prepared to offer.

363. In arriving at loan and deposit interest rates, important factors are of course the statutory requirements to maintain a cash reserve of 8% and the voluntary agreement to maintain a liquid-asset ratio of 15%; the cash component earns no interest and the secondary reserves normally yield relatively low interest. These requirements limit the amount the banks can earn from the employment of their funds, and thus limit what can be paid to depositors. Also, there must be sufficient spread between lending and deposit rates to cover banking costs.

364. Lending is done at rates above the prime rate where justified by the circumstances, but in any case the interest rate may not exceed 6%; branch managers are continually on the lookout for good customers, and

ready to seize any opportunity to gain an account from another bank. Discretion is permissible in levying certain charges in the case of a customer who carries substantial free balances or whose business otherwise warrants special consideration.

365. In the field of international banking the situation is complicated by the ease with which international corporations can transfer funds across international boundaries, and by the international operations of foreign banks; practices in this area have already been discussed in connection with the foreign currency business of the Canadian banks.

366. Under some circumstances a bank may perform special services for a customer without levying a specific charge. For example, it may sort and list cheques submitted through the clearings on behalf of a customer who maintains adequate deposit balances. Many other forms of service may be undertaken on occasion, especially to assist a new customer who is just becoming established in the area -- such things as finding office space for him, obtaining information on market conditions, discussion of business conditions generally or in the customer's industry, and so on.

Competitive Practices

367. The chartered banks compete actively in a variety of ways. Perhaps the most important is the competition for credit business, which offers the potential borrower the opportunity of discussing his needs with various bankers -- including the managers of other branches of the same bank as well as other banks. A

different manager may take a different view of the circumstances, or see a new way of meeting the customer's needs.

368. In the last analysis successful banking depends on good judgment about individual borrowers and business propositions, coupled with suffucient imagination to assist customers in overcoming difficulties, and these qualities are highly personal. One manager may see no prospect of success for a particular enterprise, say a small manufacturing operation that does not seem to be proving out; another may perhaps see that the technical side of the operation is good but the marketing side or the financial management needs tightening up, and may thereby help to convert a near-bankrupt business into a prosperous customer.

369. Whenever the spread between the prime rate and the ceiling rate permits, competition occurs in respect of the interest rates offered on loans that are not entitled to the prime rate. Naturally there are differences in judgment as to who is entitled to the prime rate, or how much above the prime rate the particular borrower should be charged.

370. Another field of intense competition is in what is known as business development. The banks are continually on the lookout for opportunities to attract new enterprises, both domestic and foreign, and to assist in the expansion of established concerns. Prospects are aided in a wide variety of ways, as

already mentioned.

371. A part of the competition in these fields takes the form of specialized knowledge of and service to particular industries. For example, several banks operate petroleum departments designed to serve that industry in Western Canada. Others have developed certain expertise in mining, agriculture, fishing, lumbering, or particular manufacturing industries, such as textiles and clothing. Similarly, most banks have economics departments which, in addition to their services to management, provide information to the general public through publications or which may offer advisory services to customers.

372. Competition for personal loans is also important, both among the banks themselves and between banks and other lenders, though its scope is limited at times when the authorities feel it necessary to discourage this type of lending. From the point of view of the banks however it is valuable business in itself, and it often leads to handling other banking business for the customer who takes out a personal loan.

373. There is active competition in soliciting deposit accounts, on a basis more or less parallelling the competition for credit business. Much depends on a good personal relationship between the staff of a particular branch and its customers. Various banks compete by offering special savings deposit plans of one kind or another, such as Christmas Clubs and term savings plans.

374. As already mentioned, competition for foreign

business is particularly intense. Here Canadian banks must meet the terms of the great international banks of other countries, but they also compete vigorously among themselves.

Branches

375. The opening of bank branches in the right places and at the right time is an important aspect of inter-bank competition. A wide and efficiently distributed network of banking offices has always been essential to any banking system in rendering service to its customers, and never more so than today. Branch banking as it has developed in Canada has shown itself capable of meeting this need admirably, from earliest times to the present. During the settlement of the prairies in the first third of this century, for example, branches brought the full range of banking services to the newest community without delay and made resources available that were not limited to local liquid savings. That is equally true of today's physical frontiers. There are branch banks at Frobisher in the eastern Arctic Islands, at Port Radium and Hay River in the Northwest Territories, and at Inuvik near the mouth of the Mackenzie River. Construction crews were greeted by the staff of a branch bank when they completed pushing the railroad through 360 miles of wilderness into Schefferville, Quebec. Banking facilities were available in Kitimat, B.C., before there was a house on the townsite. A branch bank opened in Leduc, Alberta, the day after the first producing well was brought in.

376. Branch banking has also been successful in

meeting the demands of the dispersal of population and industries around the peripheries of major cities and the development of new industrial areas. This phenomenon is perhaps less spectacular than the enlargement of our geographic frontiers, but it is a pervasive movement that is affecting a much larger proportion of all bank customers. These shifts have accentuated the problem of bringing banking service to the customers rather than expecting the customers to travel long distances to do their banking.

377. The obverse of this is that in a branch banking system each bank must maintain a network of branches across the country, and at well chosen locations covering strategic sections of principal centres and metropolitan areas, in order to bring its services close to existing customers and new prospects. A branch network also provides co-ordinated Canada-wide banking services admirably suited to the needs of those business firms that must also operate across the country. Accordingly, branch development gets a great deal of thought and attention in every bank.

378. The decision to open a new branch in a given location is based on a variety of considerations. It must fit in with the needs of a balanced geographic distribution of branches across the country. The prospects for business growth in the general area to be served must be carefully examined. The particular site must be convenient to existing and prospective customers. The number and location of branches of other banks near by and of other branches of the same bank must be

considered, for there is no profit in entering an area that is already over-banked no matter how promising it is in other respects.

379. A bank tries to be alert to locations that will serve the public and eventually pay for themselves. No branch is expected to be profitable from the start, though this does happen in exceptional cases. Generally speaking, however, a new branch is expected to start earning a profit within three to five years and will not be opened unless there are good reasons to believe that this will be accomplished. As recently opened branches become profit-earning, a bank is usually more ready to open new ones. If a branch shows persistent losses in spite of skilful management and vigorous efforts at business development it will be closed.

Bank Premises

380. Since 1945 the chartered banks have made substantial expenditures on premises in order to make up for depreciation deferred during depression and war years, to accommodate the larger staffs made necessary by shorter hours and reduced overtime, to handle the rapidly increasing volume of business being done year by year, and to keep up with modern trends in business construction, burglar proofing, and banking facilities generally. The bulk of the increase in expenditure has been on the modernization and improvement of structures already in existence in 1946; new branches account for a much smaller portion, even though many new branches have been opened. During this period there has also been a tendency towards administrative decentralization

Bank Premises, Assets, and Shareholders' Funds, Selected Years

End of Year	Shareholders Equity	Total Assets	Bank Premises*	Ratio of Premises to: Equity	Assets
	(..... Millions of dollars...)				
1926	256.9	2,939.9	70.4	27.4%	2.4%
1931	321.6	2,977.7	79.8	24.8%	2.7%
1936	288.5	3,242.3	74.9	26.0%	2.3%
1941	296.1	4,136.6	69.4	23.4%	1.7%
1946	332.7	7,798.6	64.2	19.3%	.8%
1951	374.8	9,609.8	120.0	32.0%	1.2%
1956	652.8	13,427.9	143.5	22.0%	1.1%
1961	1,071.0	19,153.5	254.2	23.7%	1.3%

Source: Statements of the Assets and Liabilities of the chartered banks of Canada compiled from returns submitted pursuant to Section 103 of the Bank Act and published at various dates as supplement to the Canada Gazette.

* Excludes controlled realty companies.

and increased responsibilities for the branch manager. In the past a good many branches were thought of primarily as savings offices, as they did relatively little lending business and functioned essentially as collectors of deposits. Nowadays, however, the decentralization of industry has greatly broadened the scope of branch activities, and there are few branches that do not have a substantial lending business. Besides requiring a higher standard of branch management, this has required more commodious branch premises. Advantage has been taken of the opportunity thus offered to introduce modern architectural advances and up-to-date ideas on furnishings and equipment. Air-conditioning is steadily becoming more widespread.

381. The accompanying table shows shareholders' equity, total assets, and bank premises for selected year-ends. It will be noted that in 1946 the ratio of premises to total assets had fallen to about one-third the level of the 1920's and 1930's, as assets grew during the war while premises declined somewhat; the subsequent expansion of premises raised the ratio once more, and for ten years it has remained close to 1.2%. On the other hand the ratio of premises to shareholders' equity appears to have stabilized again at about the pre-war level, after a moderate drop during the war and a sharp rise in the early post-war years. The abnormally high ratio in 1951 was brought about by the sharp expansion of premises in the preceding five years, which was then offset by a parallel growth of shareholders' equity in the next five years. It would appear however that the relative stability of the premises-equity ratio is not due to any preconceived idea of a necessary relationship but to the fact that the needs for both premises and capital are similarly related to the general volume of business done.

Entry Into the Banking Business

382. Traditionally in Canada entry into the banking business has been carefully regulated under the Bank Act in the interests of ensuring a sound and reliable system. In earlier days the statutory provisions with respect to minimum capital requirements and the scrutiny of the authorities were doubtless the major obstacles to be overcome. Nowadays, however, even if a group wishing to found a bank had little trouble

raising the minimum capital required and assuring the authorities of their good faith, they would find it difficult indeed to win a sizeable share of the Canadian banking business unless they could rapidly build up a trained staff and a wide network of branches. The amount of capital and the organizational work involved in so doing are surely a far more powerful deterrent than the statutory requirements.

383. Historically, the statutory provisions regarding entry into the banking business have contributed to promoting a sound system in Canada. However, times change. Much progress has been made in the understanding of the basic nature of the banking function, the regulation and control of banks, and the protection of depositors. Modern central banking techniques, bank inspection and supervision, and other measures both in Canada and in other countries have brought new discipline and taught new skills. It is therefore only fair to ask if the arguments for the present entry provisions are still valid in the public interest, for surely it is the public interest that must govern.

384. If we look no further than the performance of banks chartered under the Bank Act, there seems to be little justification for modifying the provisions that now apply to entry into the banking business. The need for sound and responsible banking practice is more pressing, not less, in a complex modern society. Many of the techniques devised in other countries to improve and strengthen their banking systems have been in large part to achieve what was already characteristic of Canadian

banking; others have already been adopted in Canada; none of them offers any reason for reversing the traditional pattern of our banking legislation. By any objective comparison with other countries, Canadian banking must be rated highly.

385. However, if we broaden our view to take in the performance of banking and quasi-banking functions by other financial institutions, a somewhat different picture emerges. Experience over the years has led to the imposition of stringent controls over the chartered banks to ensure that they are soundly operated and that depositors' funds will remain liquid in times of financial crises -- special provisions concerning shareholders' audit, rigid internal inspection, and supervision by the Inspector General of Banks; the detailed provisions of the Bank Act in relation to formation, management, and winding up; limitations on the activities in which banks may engage; and so on. This provides a formidable armoury of safeguards under federal legislation. To a somewhat similar extent the same situation, in respect of legislative safeguards, applies in the case of the two institutions operating under the Quebec Savings Bank Act, a federal enactment broadly modelled on the Bank Act. Yet many other financial institutions now hold large portions of the liquid savings of the public under conditions not greatly different from those which applied to banks in the days before the development of modern safeguards to protect the depositor. It may even be that the very success of the measures for assuring strong and sound banks has

lulled the authorities and the public alike to the dangers of unregulated banking. Our forefathers had intimate practical experience with these dangers, but this generation has not. In any case the tradition of safety built up by the chartered banks has made it easier for the near-banks to grow without actually having to provide to the public the financial protection that is nowadays taken for granted.

386. From the foregoing it can be seen that banking is far from being a monopoly. Indeed it would be hard to think of a typical banking function that is not offered by one or more competitors of the chartered banks. There are many bidders for available funds -- governments, insurance and trust companies, savings banks, and credit unions, etc., as well as the short-term investment market.

387. On the lending side, too, there are many types of credit available to individuals and corporations for a variety of purposes, much of it in competition with the banks either directly or indirectly. Manufacturers, wholesalers, and retailers extend a large volume of credit in an informal way in the ordinary course of their business. Finance companies do much of the instalment financing of retail sales of durable goods. Personal loan companies do a large volume of personal financing, much of which is in competition with the banks. Credit unions are playing an increasingly important part in the consumer credit field. Life insurance loans are for the most part based on mortgages, but even mortgage loans are directly

competitive with chartered bank lending to the extent that working capital is sometimes provided in this way; loans against life policies are a large and ready source of personal credit, and make the cash loan value of a policy comparable to a savings account in some respects. Trust and loan companies lend money on mortgages and against the security of stocks and bonds. Foreign parent companies and other foreign investors often provide working capital to subsidiary or affiliated companies in Canada. Bond issues, in addition to providing long-term capital for industry, sometimes provide funds for working capital purposes. The Industrial Development Bank supplements the activities of other lenders by providing intermediate and longer-term credit to industry, particularly for smaller enterprises. Money-market operations outside the banking system reach substantial figures; it is estimated that on occasion more than 40% of day-to-day and call loans are obtained from sources outside the banking system. There are various federal and provincial lending agencies operating in the credit field, particularly for the benefit of farmers and other specialized producers.

388. Some of these lenders obtain a portion of their financing from the chartered banks, and to this extent there is duplication in the figures for lending by banks and lending by the other sources here listed. However, a great deal of it represents the lending of bank deposits belonging to these lenders themselves or solicited by them from third parties through the offer of attractive interest rates. One of the great

gaps in Canadian financial statistics is in this field of credit operations outside the banking system, for little is known of the activities of other financial intermediaries except on a piecemeal basis and after long delay.

389. Within the banking system proper there is a very effective amount of competition. Considering the very substantial opportunities available outside the banking system, competition for neither loans nor deposits can be said to be seriously threatened. The limitations imposed on the activities of a chartered bank by the Bank Act, together with effective competition from other banks, ensures that even the largest bank cannot gain financial domination over any field of business or industry.

The Canadian Bankers' Association

390. The Canadian Bankers' Association was established on December 17, 1891. Previously bankers had met as individual members of the Toronto Board of Trade; then during the revision of the Bank Act in 1890 it became clear to them as well as to government officials that a more formal organization was required, similar to those already existing in the U.S.A. and Britain. The voluntary association was superseded by an incorporated body in 1900, in order to give the Association a more formal and official status and to make it obligatory for all new banks to become members. Among other things it was given the power of supervision and inspection over the banks' note issues, in connection with the operation of the Bank Circulation Redemption Fund

established by the Bank Act of 1890 to safeguard holders of chartered bank notes.

391. The powers and the semi-official status of an agent of the Government assigned to the Association in 1890 have since lapsed, because the chartered banks no longer have note-issuing rights. Today it has no supervisory or disciplinary powers, and is simply a trade association. Since 1891 however it has promoted the efficiency of bank employees by educational courses, has published a magazine, and has operated clearing houses across Canada. Legislation and court decisions on banking matters have been scrutinized and reported on. For many years it has provided cash rewards for evidence leading to conviction for bank robberies.

392. As it operates today, The Canadian Bankers' Association comprises all banks that are chartered by Parliament and to which the Bank Act applies. Membership results as a matter of course from the chartering of a new bank by Parliament. The Bank of Canada is not eligible, nor the Industrial Development Bank, nor the Quebec savings banks.

393. A bank's membership in the Association is exercised by its general manager, and each bank has one vote and one voice. The active head of the Association is its president, elected at an annual meeting in June. It is customary for the president to serve two one-year terms, although this has not always been the case. It is also the practice for the presidency to alternate every two years between the banks with head offices in Toronto and those with head offices in Montreal. There

are also four vice presidents, two from Montreal and two from Toronto. The president is the spokesman of the Association, and as such can speak for the whole commercial banking community within the limits imposed by the rules of the Association. His responsibilities are particularly heavy before and during a revision of the Bank Act. He is assisted in his duties and in carrying out the decisions of the Association by a small permanent staff headed by an Executive Director.

394. The Executive Council of the Association meets four times a year. These meetings are attended by the general managers of the banks or their nominees. Matters of general interest to the banks come up for consideration. The Governor of the Bank of Canada, the Minister of Finance, and the Inspector General of Banks usually confer with the general managers on the day of the meeting on business conditions and monetary matters. The routine work of the Association however is carried on by the permanent staff and by various committees formed by representatives of the banks. The Association works primarily in procedural fields of common concern to all banks and avoids fields that are competitive among banks. For instance, it exercises no influence or authority over the lending rates charged by banks. Clearing houses are established in fifty-one cities across Canada and are operated under rules and regulations made by the Association, because all banks are equally affected. Similarly, the Association provides the machinery for foreign exchange transactions among banks, the general principle being that all require the

facility equally and there is no hindrance or interference with the competitive position of any one of them.

395. Since banking is under federal jurisdiction, most of the contacts of the Association with government authorities are at the federal level, particularly the Department of Finance. In each province, however, it has legal representation to keep it informed of legislation having an effect on banking. It has sometimes happened, also, that provinces have asked the Association for advice and co-operation on some specific subject.

396. As already mentioned, much of the Association's work is dealt with by committees. Each bank is usually represented by someone versed in the particular field under review; in this way the Association can call upon men of expert knowledge, so that the committees' reports are based on a wide range of experience and training.

SECTION II

COMPETITION WITH OTHER FINANCIAL INSTITUTIONS

The Role of the Chartered Banks

397. The Canadian chartered banks have traditionally been the chief depositories for personal savings and have also been the chief source for most kinds of short-term business financing and personal loans. In addition, they have long played an important role in government financing as purchasers of Government of Canada securities, and more recently they have provided a foundation for the growing Canadian money market, which depends in a substantial degree on the fact that the chartered banks keep a secondary reserve in the form of day-to-day loans to money market dealers and Government of Canada Treasury bills. Under the National Housing Act, until the going rate of interest went above the maximum permitted the banks, they made a substantial contribution to residential mortgage financing, a field otherwise prohibited by the Bank Act. Since the establishment of the Bank of Canada, monetary policy has also been implemented primarily through the effects on chartered bank operations of variations in bank cash permitted the chartered banks by the Bank of Canada. The operations of the chartered banks are also regulated in detail by the terms of the Bank Act, as well as by certain of the terms of the Bank of Canada Act. Among the key points of these controls are the statutory limitation of 6% in the rate which may be charged for bank loans, the statutory requirement to hold 8% cash

against Canadian deposit liabilities, together with the supplementary agreement on secondary reserves, and the prohibition under the Bank Act of acquisition by the chartered banks of certain types of assets, notably conventional mortgages.

Development of Other Financial Institutions

398. Over the years a considerable number and variety of other financial institutions have developed in Canada in competition with the banks. Although none of these other institutions offers a full range of banking services, each of them has taken on some functions and services of an essentially banking nature. To the extent that these other institutions may have developed by providing services and facilities which for one reason or another the chartered banks did not provide, the result may be regarded as a desirable growth in the range and flexibility of banking and financing services in Canada, although it has also produced problems in the field of monetary policy for which solutions are needed. However, to a very considerable extent these competing institutions have made such rapid headway in circumstances in which the chartered banks were prevented by legal or other rigidities from competing effectively in the areas taken over by the competing institutions. It might be pointed out that some of these competing institutions enjoy freedom from income taxation.

399. The major functions of a banking nature performed by these other institutions are primarily the acceptance of savings and other deposits in various forms

from the community; the provision of loans for a wide variety of purposes; the provision, in some cases, of the equivalent of chequing services, made possible, in practice, by access to the chartered banks' clearing system; provision, in some cases, of safety deposit boxes and other safekeeping services. These functions are performed without the limitations enforced on the chartered banks by the Bank Act, the Bank of Canada Act, and certain "agreed" arrangements with the Government and the Bank of Canada. "Banking" is not defined in our legislation and various possible definitions, from the point of view of economic analysis, are in varying degrees inadequate or misleading. However, from the point of view of monetary policy these institutions are important instruments for the expansion of credit in the economy and, as such, their operations directly affect the success or failure of monetary policies even though they are not, like the chartered banks, directly amenable to control in the interests of official monetary policy.

400. Among these competing institutions are credit unions and caisses populaires, finance companies, small loan companies, factoring companies, trust and mortgage loan companies, insurance companies, participants in the short term money market, provincial government savings offices, and the Post Office Savings Bank. These institutions are all competing actively for the savings or loanable funds of the community, and all have much greater freedom than do chartered banks in the way in which they can invest such savings and other funds, and therefore in the returns which they can pay to

lenders and depositors. Government of Canada Savings Bonds are also a very important savings instrument involved in the general competition for the community's savings.

401. Some credit unions and caisses populaires now make "chequing" privileges available, and some of them invite regular business accounts, grant commercial loans, discount paper, and, in short, conduct a general banking business. Their original emphasis was on the granting of small personal loans to fellow members, but they have been moving more and more into the fields of long-term mortgage lending and other investments in sizeable amounts. Under Quebec legislation there is no limit as to the interest paid on deposits or charged on loans by the caisses populaires. Credit unions in a number of other provinces are limited in their loan rates to 1% per month on the unpaid balance.

402. It should be particularly noted that co-operatives, credit unions, and caisses populaires have substantial tax advantages. Their interest rates on savings and shares vary, and sometimes there are insurance features which would increase the effective rate, but the rates are of the order of 3% on deposits and 3 to 5% on shares.

403. Trust and mortgage loan companies also compete intensively for deposits, primarily by offering higher interest rates. They are rapidly extending their network of branches, and some offer chequing facilities against savings accounts. They also accept deposit accounts from which cash withdrawals are permitted, and

they offer term guaranteed investment certificates, usually of one-year to five-year maturities. Mortgage loan companies issue debentures in terms of one to five years at interest rates from 4 to 5%. A large part of the assets of the trust companies is invested in the form of mortgage loans. Their current rates on mortgages are of the order of 6-3/4 or 7%. The rates now offered depositors generally vary from 3-1/2 or 4% on some types of accounts to 5% or more on longer-term guaranteed investment certificates, although there is a great deal of variety in the terms and rates offered.

404. Two provincial governments, Alberta and Ontario, have provincial government savings offices. These organizations solicit savings, are exempt from income taxes, and in Alberta make loans, including loans against the security of land mortgages.

405. Instalment finance companies are primarily in the business of providing loans to buyers of durable goods, both retail and wholesale. The credit they supply is normally short term and they therefore obtain their funds mainly by short-term borrowing, largely in the form of notes and debentures and bank loans. Bank loans in recent years have supplied a decreasing proportion of these funds. The smaller companies still rely to a relatively greater extent on bank loans, while the larger ones depend increasingly on the role of their own short-term notes to other financial institutions or directly to corporations. The assets of these finance companies are invested primarily in instalment loan contracts, i.e., "retail paper", at

interest rates which vary considerably and over which there is no legislative control.

406. Small loan companies and licensed money lenders, some of whom report to the Superintendent of Insurance, are engaged mainly in the field of personal instalment loans. They are permitted, under the Small Loans Act, on loans up to $1,500, to make charges as follows on the unpaid balance of a loan; the aggregate of 2% a month on any part of the unpaid principal balance not exceeding $300, 1% a month on any part of the unpaid principal balance exceeding $300 and not exceeding $1,000, and 1/2% a month on any remainder of the unpaid principal balance exceeding $1,000. The Act puts no interest ceiling on loans above $1,500 and requires that only those lenders who charge more than 1% a month on unpaid balances, on loans of $1,500 or less, be licensed.

407. Life insurance companies in Canada have very great flexibility in their choice of assets in which to invest the funds obtained from their policies. They may invest in all types of government guaranteed debt -- federal, provincial, or municipal, Canadian or foreign -- corporation bonds and preferred stocks, and, within specified restrictions, common stocks. They may make loans on the security of bonds and debentures, shares, mortgages, and life insurance policies. They may invest any portion of their assets in mortgages provided each loan does not exceed 66-2/3% of the value of the real estate covered.

408. In dealing with alternative sources of credit

Professor R.S. Sayers, a member of the Radcliffe Committee, goes even further. "Nor should we limit the range to firms ordinarily regarded as financial intermediaries. Among firms whose main activity is manufacturing or trading most do a great deal of lending and borrowing: they extend 'trade credit' to their customers and they take 'trade credit' from their suppliers .... The distinction between banks as creators of credit and other firms as users or intermediaries in the monetary field is if not completely false at least misleading. From the point of view of the pressure of effective demand, the crucial step is that which increases the power to acquire goods and services, on the part of people inclined to exercise it immediately; and banks are by no means the only firms to place this power in the hands of others. (R.S. Sayers "Monetary Thought and Monetary Policy in England", <u>The Banker</u>, October, 1960, p. 671.)

409. Another competing institution is the Industrial Development Bank. Established in 1944, it has been expanding its operations significantly in the last year or so. Its original function was the provision of intermediate-term credit for industrial purposes, but it is now widening its activities to every type of business enterprise. Some of its lending business in the last year or two would appear to have been directly competitive with the chartered banks. Its lending rate has gone as high as 7% and is currently 6-1/2%, or higher than the rate permitted by law to the chartered banks. The Act setting up the Industrial Development

Bank fixes no maximum rate. The I.D.B. has apparently been unimpeded by various periods of tight money. Total loans outstanding at December 31, 1961, were $133.4 million. It is not unreasonable to assume that the ready availability of central bank funds to the I.D.B. even through times of very tight money, together with its freedom in interest rates, has enabled it to attract loans which otherwise might have been accommodated by the chartered banks if they had equal freedom in their operations.

Access of Near-Banks to Clearing System

410. Full details of the arrangements for near-banks' access to the clearing system are set out in an Appendix.

411. The banks have given a great deal of careful study to the question of how the ever-increasing volume of cheques and orders can be handled most efficiently, bearing in mind the criteria for their acceptability as a means of payment, which are ease of negotiation for holders and the earliest possible reimbursement to negotiating banks and near-banks, and the need for equitable apportioning of clearing costs. In this respect the banks have been negotiating on the following basis:

(a) All near-bank organizations and institutions that accept deposits and offer chequing facilities to their customers should be required to assume their proper share of the function and cost of clearing the cheques and other instruments which they negotiate and the orders

which they permit their customers to draw on them knowing that the banks will be called upon to negotiate most of these orders. To this end the near-banks which have not already done so should be required to provide clearing facilities co-ordinated with the banks' clearing facilities in the manner described below.

(b) Local cheques and local orders, negotiated locally, would be cleared locally, and settled for through a current account conducted with the main branch of a bank.

(c) Each near-bank would provide central clearing facilities through its central organization, branch, or office (herein called the "central office") at the central clearing point for the province in which the near-bank is located. The central office would conduct with the main branch of each bank at that point a current account through which settlement for orders, cheques, etc. would be made (herein called the "clearing account"), except that where the volume of clearing items does not exceed a suitable limit determined by the local clearing house the clearing account may be conducted with only one bank.

(d) All cheques and other items clearable through banks (except local items) negotiated by near-banks would be sent by the near-bank to its central office at the central clearing point

for the province and deposited in its clearing account there, each bank receiving all items payable at its own branches except where a clearing account is conducted with only one bank. The banks accepting the items on deposit will clear them to the points at which they are payable.

(e) Orders drawn on near-banks negotiated by banks (except local orders) will be sent by the bank to its main branch at the central clearing point for the province and, if the near-bank has no central office at that point, the orders will be cleared by the banks to the nearest central clearing point at which the near-bank has a central office. The orders will be charged to the clearing account of the near-bank's central office and the latter will clear them to the offices on which they are drawn.

(f) The banks must recover by way of clearing fees the full cost of handling the orders plus a reasonable margin of profit. If the full cost is not recovered, the effect would be that part of the cost which should be allocated in full to the near-banks and their customers for whose benefit the chequing facilities are provided is shifted to the banks and their customers who would then be paying the cost of the banks' chequing facilities plus part of the cost of the near-banks'

chequing facilities. This would give the near-banks the competitive advantage of being able to offer lower charges or higher interest rates, or both, in order to attract public deposits.

Clearing At Par by the Bank of Canada

412. This is another point relating to the clearing system on which our comments have been requested.

413. In attempting to develop the arguments for and against having clearing undertaken at par by the Bank of Canada, it may be well first to describe the present situation and to emphasize that the reference is capable of several interpretations.

414. The banks have already gone a long way themselves towards universal par clearing arrangements. Since June 1960 all out-of-town cheques have been cleared to and redeemed by the drawee banks at their nearest central clearing point (i.e. Halifax, Saint John, Montreal, Quebec, Ottawa, Toronto, Winnipeg, Regina, Calgary, and Vancouver) and each drawee bank, therefore, carries the debit float on its own cheques from the date of settlement until eventual payment. These cheques may be divided into two categories as follows:

(a) Cheques drawn on branch points, i.e. points where both the negotiating bank and the drawee bank are represented.

(b) Cheques drawn on non-branch points, i.e. points where the negotiating bank is not represented.

Cheques in category (a) are accepted at par by the drawee bank. Cheques in category (b) are accepted by the drawee bank, subject to the following commissions which are deducted from the amounts charged to drawee banks. (The exceptional procedure for cheques of $50,000 and over is a device to reduce the amount of debit float outstanding in the books of the drawee banks and such items are cleared by direct cheque-list to the branch concerned despite the clearing arrangements which prevail for other items.)

Cheques up to $5,000	5¢ per item, plus 1/10% of the daily total.
Cheques over $5,000 to $25,000	1/20% minimum $5 each item.
Cheques over $25,000 to $49,999.99	1/32%, minimum $12.50 each item.
Cheques $50,000 and over	No charge. These cheques are charged to drawers' accounts on date of negotiation after advice by wire.

415. Briefly, therefore, the only cheques which are NOT being exchanged at par as between banks are those on non-branch points (see category (b) above) for less than $50,000.

416. At Bank of Canada points the clearing house manager provides the local agent of the Bank of Canada with a list of the balances due to or by each bank. Each bank confirms the balance direct to the agent, authorizing a debit or credit, as the case may be, to the bank's account in Ottawa. Instructions are then despatched by the agent to Bank of Canada, Ottawa.

417. This settlement is on a par basis from the

Bank of Canada viewpoint, all commission deductions and adjustments of any type having been made at the level of the clearing houses maintained jointly by the banks in larger centres and at central clearing points.

418. It would, of course, be to the banks' advantage to avoid the routine labour involved in the collection of inter-bank commissions if this could be achieved without any significant loss in revenue to the individual banks, by reason of the disparity in branch representation, and already the possibility of eliminating this, or substituting a monthly lump-sum inter-bank payment, is being studied. In arriving at a basis for assessment of a fixed monthly payment consideration will have to be given to the avoidance of involved record-keeping and statistical processes, which otherwise would neutralize any labour-saving achieved. If we arrive at this condition, which would seem to be essential when electronic sorting of cheques materializes, we shall have in effect par clearing as between the banks without intervention of the Bank of Canada at all.

419. If it is the thought that the Bank of Canada might assume in some way the physical handling of the clearing of cheques we cannot see what this will accomplish nor can we see how this would reduce appreciably the cost to the banks of their present clearing operations.

420. There is frequently misconception of the functions of a clearing house in Canada. It must be borne in mind that there is no detailed listing of cheques at the clearing house which is in distinct

contrast to the situation in the United Kingdom, where, for instance, items passing through the Town Clearing (London, England) are listed at the clearing house itself, which is specifically equipped for this function. These items represent some 80% of the sterling total of clearings processed by the London Clearing Bankers. A similar situation prevails in the United States where the Federal Reserve banks undertake a quite considerable physical handling of cheques. In Canada, the physical exchange of cheques may take place early in the morning, before the clearing settlement which only occupies a few minutes or, in centres where the banks employ night clearing staffs, even the night before.

421. At present, each bank must sort the cheques it receives on deposit from its own customers into (1) those drawn on its own bank, and (2) those drawn on other banks, with the cheques of each bank being sorted separately. If the Bank of Canada were to intervene, a bank would still be required to make the same two sorts, although presumably it might not be necessary to sort by individual banks, but if "other" banks' cheques were sent to the Bank of Canada in one block, this would provide only minor relief in the sorting task. If the sort into banks was transferred to the Bank of Canada, it must be assumed that, on completion, the Bank of Canada would merely turn over to each bank the cheques drawn on its own branches. Each bank would then have to sort these cheques by branch. It is inconceivable that the Bank of Canada would attempt to send a cheque list each day to each branch bank in Canada, but it is the branch

sort which causes the greater part of the cost of clearing, and there would be little possibility of achieving cost savings by having the Bank of Canada handle only the bank sort. It should be emphasized that almost all the cost of the clearing and transit function occurs within the banks and is incurred to a certain extent in every branch.

422. We are unable to see, therefore, how the introduction of the Bank of Canada into the physical clearing processes would do other than cause delays in the handling of negotiable instruments and add considerably to the present cost of clearing. It is noteworthy that the number of items passing through the chartered banks' clearing system is currently at a rate of 614,000,000 per annum. A further important consideration is that one of the probable avenues leading to maximum automation is the centralization of the cheque-handling function and the deposit-accounting function, with some of the processes of both being carried out simultaneously. Since it would be quite inappropriate for the Bank of Canada to be involved in the latter function its introduction into the cheque-handling function would probably inhibit the full development of bank automation.

423. In the United States, the physical clearing of cheques is handled in the main, but not exclusively, by the Federal Reserve system, but the two situations are not comparable. Canada has eight chartered banks having access to the clearing system, whereas in the United States there are about 14,000 banks and it is

patently clear that some centralized procedure is essential in these circumstances. Even so, any U.S. bank with a branch system carries on its own inter-branch clearing in the same manner as in Canada. In the United Kingdom a physical sorting, listing, and exchange of cheques takes place at the London Clearing House, but this is an organization created by the London clearing banks and there is no intervention by the central bank.

424. It has been said, in favour of Bank of Canada participation in the clearing system, that with the introduction of electronic cheque processing, the individual banks could not justify the purchase of the necessary costly machines. If this were the case, and we do not agree that it is, it is difficult to see how similar expenditures should be undertaken by the Bank of Canada in respect of a programme from which it would receive no benefit whatever.

425. It is our view that each chartered bank must enter the electronic age on its own, or jointly with other chartered banks, at some time or another if it is to reap the maximum benefits from automation. The intervention of the Bank of Canada would be a pointless addition to the costs of the Bank of Canada itself, and would impede progress by the chartered banks in this direction. To ensure that full advantage is taken of the opportunities afforded by electronic equipment in such areas, for example, as centralized bookkeeping, each chartered bank must have such equipment under (a) its own control or (b) the control of the chartered banks where competition would force an arrangement reasonable

from a competitive and cost standpoint.

Short-term Money Market

426. In another field, that of the short-term money market, the chartered banks have been encountering new forms of competition from a wide variety of institutions engaging in financial operations. An official money market commenced in Canada in 1954 with the offering by the chartered banks of day-to-day loans to money market dealers approved as participants by the Bank of Canada. As grantors of these day-to-day loans, and as the principal investors in treasury bills and short-term Government of Canada issues, the banks have from the beginning been substantially involved in the official money market. Although they were already full and active participants, they were requested in November 1955 by the Governor of the Bank of Canada to hold, in addition to the prescribed cash reserve of 8% of Canadian deposit liabilities, an additional reserve in day-to-day loans and Government of Canada Treasury bills in such amounts that the total of cash, day loans, and bills would average no less than 15% of deposit liabilities for each month. This has meant that the banks do not have the same flexibility as other participants in the short-term money market, and other participants in the market are sometimes in a position to take advantage of the fixed requirements of the banks. This additional requirement also limits the ability of the chartered banks to shift their resources from short-term money market to other investments and loans, if this should seem desirable. Many corporations, either

directly or through trust companies, now invest short-term funds in the money market. In many cases these are funds which might otherwise have been left on deposit with the chartered banks. Corporations of sufficient financial standing are also now able to sell their own promissory notes in the money market rather than seeking loan accommodation from the chartered banks. The fact that such corporations have established lines of credit with their bankers naturally strengthens their position in selling their commercial paper in the money market. Finance companies working through money market dealers also attract considerable funds from the money market through the sale of various short-term instruments. This is an alternative to utilizing their lines of credit with the chartered banks. The banks have developed short-term interest-bearing deposit instruments of their own to meet this competition.

427. The development of this aspect of the money market has added considerably to bank costs. In the first place the banks have to face the additional interest expense of their own new deposit instruments. Furthermore, the result of the increasing use of near-banks has seen a rise in deposit velocity and hence cheque handling routine in relation to balances carried.

428. The existence of the money market also affects the banks by producing a lower level of both loans and deposits than would likely be the case if corporations did not "trade" deposits among themselves (providing the central bank permitted both to rise).

429. In effect, then, despite the fact that the

banks now operate with an 8% cash ratio instead of the former 10%, the net results of the growth in the money market may have been harmful to bank earnings rather than helpful. At the same time, the banks are in danger of losing corporate deposits to other financial intermediaries through their inability to offer competitive interest rates. It should also be noted that, while the money market does provide an avenue for short-term financing, it is impersonal in its operation and provides no assured element of continuity for the borrower. Nor does the money market provide those ancillary banking services on which the users of the money market depend, and which still have to be provided by the banks.

430. Nevertheless the chartered banks recognize that the development of the short-term money market has brought advantages to other major participants. The Bank of Canada now has improved facilities for conducting open market operations; the Government is enabled to finance a larger part of its debt at lower rates, much of it necessarily held by the chartered banks as a result of the additional reserve requirement. The money market has also provided profitable opportunities for the official money market dealers, whose operations are based on their access to day-to-day loans at the banks and to last resort facilities at the Bank of Canada, and for large corporations and other institutions with short-term funds to invest.

The Competition for Savings

431. An important aspect of the chartered banks'

functions is to gather funds from those who have surpluses and to make them available for use in the economy by others. But the chartered banks are only one of a number of competing institutions which act as financial intermediaries and, in a flexible economy, it is inevitable that there will be changes over a period of time. At times new institutions may enter the field and expand operations while other financial institutions decline in importance.

432. In general it may be said that the chartered banks, which accept deposits either repayable on demand or at short notice, are similar to some financial intermediaries, such as trust and loan companies, but considerably different from life insurance companies or pension funds, which include other functions along with the gathering of savings. Factoring companies, for instance, are another type of intermediary. In this case, while they deal with the public as direct lenders, in general they borrow from other intermediaries. In addition, however, there are now other savings media such as Canada Savings Bonds, which are regarded as undoubtedly safe and liquid instruments, in many ways akin to deposits.

433. Competition for the liquid resources of the community has intensified in the post-war years. As shown in Tables I and II, the chartered banks' share over this period has declined from 87% of the given total in 1947 to 74% in 1960. This continuing relative decline is of importance to the chartered banks, and may have serious repercussions on the economy. If this

trend had been the result of free and unrestricted competition among the financial institutions involved, the public interest would have been served. This has not been the case, however, as the banks do not enjoy the same freedom as their competitors. The total of chartered bank deposits is regulated directly by the central bank in the interests of contra-cyclical monetary policy. No such direct influence is exercised over deposits in competing institutions. Indeed, during recent periods of monetary restraint, when chartered bank deposits were being held down by central bank action, total deposits in the near-banks continued to expand rapidly. For instance during the two years 1959 and 1960, while chartered bank deposits rose 1.8%, deposits, etc., in the other competing institutions listed in Table I, i.e., Quebec Savings banks, credit unions, government savings institutions, trust and loan companies, mortgage companies and finance companies, rose [illegible]7.4%. (Investment by the public in Canada Savings Bonds rose by 24.1% in the same two years). The banks are at a disadvantage in attracting deposits because of limitations on their ability to pay rates of interest on deposits comparable to those paid by near-banks.

Implications for Monetary Policy

434. Under present conditions, as competing forms of financial claims grow relative to chartered bank deposits, monetary policy has either to become more broadly directed against the total supply of liquidity or progressively more vigorous on chartered bank deposits in order to bring about a given expansion or contraction

TABLE I

OBLIGATIONS OF SELECTED FINANCIAL INSTITUTIONS

($ Millions)

Year ended	1947 1/	1955	1956	1957	1958	1959	1960	% Increase 1960/1947	% Increase 1960/1955
Chartered Banks:									
Canadian Dollar Deposits	6446	10847	11162	11407	12690	12279	12921	100.4	19.1
Others:									
Quebec Savings Banks - Deposits	161	247	252	268	285	282	295	83.2	19.4
Credit Unions - Shares & Deposits	206	603	700	787	935	1060	1196	480.6	98.3
Government Savings Institutions - Deposits*	129	188	192	195	201	189	196	51.9	4.3
17 Trust Companies - Deposits & Certificates	230	574	593	626	798	888	1093	375.2	90.4
7 Mortgage Companies - Deposits & Debentures	189	463	494	531	594	662	733	287.8	58.3
Finance Companies - Notes & Debentures	60	587	797	935	816	1009	1111	1751.7	89.3
(Total Others)	(975)	(2662)	(3028)	(3342)	(3629)	(4090)	(4624)	374.2	73.7
Total Above Obligations	7421	13509	14190	14749	16319	16369	17545	135.8	29.9

*as at Mar. 31 of following year.

1/ The year 1947 is the first year for which comparable data are available.

Source: Bank of Canada Statistical Summary.

TABLE II

OBLIGATIONS OF SELECTED FINANCIAL INSTITUTIONS

(Percentages)

Year ended	1947	1955	1956	1957	1958	1959	1960
Chartered Banks:							
Canadian Dollar Deposits	86.9	80.3	78.7	77.3	77.8	75.0	73.6
Others:							
Quebec Savings Banks - Deposits	2.2	1.8	1.8	1.8	1.7	1.7	1.7
Credit Unions - Shares & Deposits	2.8	4.5	4.9	5.3	5.7	6.5	6.8
Government Savings Institutions - Deposits.	1.7	1.4	1.4	1.3	1.2	1.2	1.1
17 Trust Companies - Deposits & Certificates	3.1	4.2	4.2	4.2	4.9	5.4	6.2
7 Mortgage Companies - Deposits & Debentures	2.5	3.4	3.5	3.6	3.6	4.0	4.2
Finance Companies - Notes & Debentures	0.8	4.3	5.6	6.3	5.0	6.2	6.3
(Total Others)	(13.1)	(19.7)	(21.3)	(22.7)	(22.2)	(25.0)	(26.4)
Total Above Obligations	100.0	100.0	100.0	100.0	100.0	100.0	100.0

of total money expenditure. When monetary policy is restrictive heavy pressure is placed upon the banks which is not shared by other financial intermediaries. Consequently, under these conditions the near-banks can and do expand at a time when the chartered banks are required to restrict their growth. It follows, under these circumstances, that the central bank is forced to be even more restrictive as the chartered banks' relative position declines.

435. One way of explaining this phenomenon is in terms of changes in the velocity of circulation of money. The Bank of Canada has very succinctly described this process in these terms:

> While the central bank can influence the quantity of money (currency and bank deposits), there is no fixed relationship between the quantity of money and the rate of spending. At any given moment a varying proportion of the money supply is inactive, lying in dormant deposits, but capable of being activated if sufficient incentive is offered. Rising interest rates and increased efforts by would-be borrowers cause owners of previously inactive deposits to lend them to those who want to make capital expenditures, or other expenditures. The degree of quantitative restriction that would be needed to overcome the increase in "rate of turnover" of deposits is very great in the early stages of a boom (when it is most difficult to adopt a really rigorous policy) but the scope for further

> activation of inactive deposits diminishes over a period of time.
>
> . . . .
>
> A special case of credit expansion feeding on the process of activation of inactive deposits assumed significant proportions during 1955 and 1956, namely, a very large increase in the volume of consumer credit, particularly as financed by instalment finance companies and small-loan companies . . . .
> Finance companies carry on an operation which is in all essentials banking, but are not restrained by changes in monetary conditions. They are able to compete for deposits through the sale of short-term paper in the money market and to raise funds in securities markets, paying any necessary rate of interest for these purposes, for increased interest costs do not appear to deter consumer borrowing. (Bank of Canada, <u>Annual Report</u>, 1956, pp. 24-26.)

436. The rise in the velocity of demand deposits in the post-war period raises the question of whether or not there is a long-term trend operating and, if so, where it is headed. Velocity previously approached its present levels in the speculative boom of 1959, then dropped to very low figures immediately after the 1939-45 war. Part of recent increases may, therefore, be considered as simply a return to a more normal level. However, the post-war growth in deposit turn-over has in general followed such a steady upward pattern that there is little reason to believe it will not continue,

and indeed its physical limits are somewhat obscure.

437. Studies in the United States suggest there is a close correlation between velocity of demand deposits and business cycles. (George Garvey, Debits and Clearings Statistics and Their Use: Washington 1959, p. 80 et seq.) However, the Report of the Commission on Money and Credit, while acknowledging that non-bank financial institutions have played some role in increasing velocity during periods of economic expansion, concludes that in general the effect is not important.

438. Nevertheless in Canada in 1959 the combined liabilities of credit unions, trust companies, finance companies and mortgage loan companies increased by $461 million, thus enabling them to expand their loans by about the same amount, at the very time when central bank policy was bringing about a decline of $411 million in the Canadian dollar deposits of the chartered banks (Table I). The spending of the loan proceeds, together with the successive rounds of re-spending generated by the rise in money incomes thus initiated, obviously involved a substantial volume of bank debits (and a much smaller volume of near-bank debits), but there is no simple or accurate way of determining what the volume was, so the net effect on monetary velocity cannot be readily ascertained. Still, it would surely have been a significant contribution to monetary stability if there had been some way of restraining the expansion of loans by near-banks in 1959. In other words it is the growth of the resources available to near-banks, and the additional lending and spending that this makes possible,

that is of importance for monetary policy.

439. This leads into an alternative way of explaining the relative importance of near-banks, which relates to the total liquidity of the community rather than to the velocity of circulation. For example, the Radcliffe Committee suggests the object of monetary policy should be to affect the level of total demand "by altering the liquidity position of financial institutions and of firms and people desiring to spend on real resources. The supply of money itself is not the critical factor. (Report, p. 135.) What was more important in their view was the total supply of liquid assets, including near-money assets of the type mentioned above.

440. Mr. Manning Dacey in his criticism of the Radcliffe Report (W. Manning Dacey, Money Under Review, London 1960, p. 32.) noted that:

> A community which formerly held only actual money, finding itself in possession of a growing stock of such assets (near-money) would undoubtedly begin to feel more liquid. Its members would feel less need to hold as large balances as before of actual money, be more willing to run down their cash balances, relying on the possibility of mobilizing their assets if the need arose. In traditional terminology, therefore, we should say the growth of liquid assets other than money will tend to raise the velocity of circulation: a given money stock, reinforced by secondary liquid assets, will support a larger volume of

spending than the same money stock without such reinforcement.

441. The financial framework in Canada after the Bank of Canada opened for business in 1935 was perhaps suitable to the financial structure of the country at that time and for some years afterwards, when the chartered banks held the liquidity media in the country as shown in Table I. However, it has been shown that in the post-war period other financial claims there listed have developed in competition with bank deposits.

442. Commenting on similar developments in the United Kingdom Professor Sayers noted:

> . . . restriction of the supply of bank deposits, if long continued, can be expected to become increasingly ineffective as a curb on total demand because the demand for liquidity can be so well satisfied from other sources. Worse than this, restriction of the banks will increase the opportunities for alternative lenders, so that the banks will lose ground to their competitors and the heads the government can hit will become progressively less influential in the behaviour of the economy. (R.S. Sayers, _Op. Cit._, p. 682.)

While Sayers' remarks refer to the situation in the United Kingdom his conclusions might also apply to the Canadian scene.

Discriminatory Restrictions on Chartered Banks

443. There are at present a number of limitations of a discriminatory nature on the activities of the

chartered banks and a consequent reduction in the sources of financing available to the public.

444. The 6% legal maximum interest rate is perhaps the most important of these restrictions which apply only to the chartered banks and not to other financial institutions. This ceiling may once have reflected public attitudes more understandable then than now, when the banks were the only financial institutions of consequence in the country. In present circumstances it is difficult to find a rational explanation for it. A very large volume of bank lending is, in any case, done at rates lower than the legal maximum. This indicates that banks, like other financial institutions, must meet the going rates in each of many areas of financing. The rates charged reflect the cost of money, the nature of the risk, the costs of doing the business, and other relevant factors including the vigorous competition of other banks and other institutions. In some areas of financing the going rates are above 6%. These rates too reflect such factors as risks and costs but it is quite conceivable that the rates are in fact higher than they might be if chartered banks were allowed to compete at rates which would give them a fair return but which might well be less than is now charged by lenders shielded from such competition. Chartered banks would also, of course, be in a position to pass on to their depositors an appropriate share of any benefits resulting therefrom.

445. It is noteworthy that the cost to business enterprises of borrowing money from the banks is

normally very small in relation to their total costs of doing business, while, on the other hand, the cost of long-term funds from other sources for such projects as, for example, utilities, major plant construction, and pipelines, is a decisive element in the total cost and often determines whether or not the project can be carried out. Yet there is a price ceiling on the first category of lending, and an open market without any legal limitation for the second category.

446. Some of the rates charged by other institutions have already been mentioned, but are recapitulated below. The following examples, as at November, 1961, are instructive:

Insurance Companies, Investment Companies, Trust Companies and other Mortgage Institutions

6-3/4% to 7% or more on mortgages

Small Loan Companies

1-1/4% to 2% per month (range of effective rates of major companies)

Caisses Populaires in the Province of Quebec

6-1/2 to 6-3/4 and 7% (usually including the cost of insurance) on mortgages as well as personal loans.

Credit Unions and Caisses Populaires outside the Province of Quebec

1% per month on the unpaid balance

Central Mortgage & Housing Corp. (Maximum rate)

6-1/2% on mortgages

Industrial Development Bank

6-1/2% on loans secured by mortgages or liens.

447. Six and one-half per cent is the rate currently being charged by the I.D.B. However, during 1959 and most of 1960 it charged 7%. The Act setting up the I.D.B., unlike the Act regulating chartered banks, sets no maximum rate and allows the I.D.B. complete flexibility to meet changing market conditions. The fact that the Government's bank, whose loans are comparable to many bank loans, has not been limited by an interest rate ceiling is a fair indication of the reasonableness of the case against such a ceiling.

448. The practical impact of the 6% ceiling was demonstrated most acutely in the summer of 1959. As the Treasury bill rate rose towards 6% it became theoretically possible for bank customers to borrow at the prime rate and invest the funds in Treasury bills or other short-term securities at a profit. At the same time large business customers, who had been raising funds for short-term working capital in the "street" from non-financial institutions while market rates were lower than the rates charged by the banks~~,~~ suddenly found that the prime rate of the chartered banks was lower than the cost of "street" accommodation. They therefore approached the banks to draw down lines of credit which often had not been used for months or years,

so that the banks found themselves with a sharp increase in the demand for large business loans at the same time that the demand for other kinds of credit was also extremely strong. The 6% ceiling in this case not only prevented the banks from using the traditional device of raising prices to moderate demand but actually intensified the demand itself.

449. The interest rate rigidity has also had a profound effect on what has traditionally been one of the main features of the operations of Canadian chartered banks, i.e., the attraction of savings deposits. In the last ten years the rate of growth of savings in a variety of competing institutions has been much greater than in the chartered banks.

450. The chief reason has been that these other institutions, since they are able to invest a very substantial proportion of their total assets in higher-yielding investments, notably conventional mortgages, are likewise in a position to pay a higher return on savings obtained from the public. This results in a progressive limitation on the resources available to the chartered banks for lending and investment activities, and in fact makes it possible for funds to be attracted to depositories not subject to adequate safeguards.

451. It is sometimes argued that, provided these other institutions continue to maintain their cash balances in the chartered banks, the only result of this shift of savings deposits is a change in the ownership of the deposits in the chartered banks -- with deposits from trust companies, etc., replacing those of

individual owners of savings deposits -- and that the cash reserves of the chartered banks are in any case regulated by the activities of the Bank of Canada, so that there is no necessary reduction in the lending and investing capacity of the chartered banks as a result of this drain of savings to other institutions. In fact, of course, the decisions of the central bank authorities as to the cash reserves to be allowed the chartered banks, and hence the decision as to the amount of financing the chartered banks are to be allowed to do at any time, must take into account the volume of financing being done outside the banks. If free competition were established between the banks and the other institutions, and if as a result the banks began to attract a growing share of savings deposits, and were in a position to compete for a share of the higher-yielding investments now taken by these other institutions, the decisions of the central bank as to chartered bank cash would undoubtedly take into account the larger requirements of the chartered banks. There is, in short, no way of avoiding the fact that the loss of deposits to competing institutions affects the chartered banks in exactly the same way as the loss of business affects any other commercial institution.

452. The primary and secondary reserve requirements, imposed only on the chartered banks, amounting in total to 15% of deposit liabilities, are a further important limitation on the freedom of action of the chartered banks in their efforts to make the most effective use of their resources in competition with other

financial institutions. Cash reserves, as a minimum percentage of deposit liabilities, were originally intended as a safeguard to the depositors, i.e., to the general public. With the present structure of inspection and supervision, both by the banks themselves and by the Inspector General of Banks, appointed by the Federal Government, this is no longer the main purpose of cash reserves. The normal working requirements of the banks would dictate some level of cash reserves whether or not any legal requirements existed. The 8% legal cash ratio, however, introduces a rigidity not faced by competing institutions. A further rigidity is introduced by the undertaking to hold secondary reserves in the form of Treasury bills and day-to-day loans to money market dealers in amounts such that these assets together with cash are equal to 15% of deposit liabilities. This is not in a true sense a reserve, since it is not available for use; rather it is a forced investment. Thus, regardless of alternative investment opportunities which may well be more attractive at any particular time, the chartered banks are under the obligation to maintain substantial holdings of normally low-yielding assets. The consequence of these arrangements is that the chartered banks, alone among financial institutions, must pay a substantial direct cost, in the form of lower returns on their assets than would otherwise be available, as part of the current arrangements for implementing the Government's monetary policy and to facilitate, through the money market, the implementation of the Government's fiscal policy. The ability of the chartered banks to

compete effectively with other financial institutions is clearly unfavourably affected by their undertaking, based on a formal request from the Bank of Canada, to hold 7% in specified low-yielding assets in addition to the legal requirement to hold 8% of their assets in cash on which there is no return.

453. These reserve requirements are a basic element in a further restriction on the ability of the chartered banks to compete effectively with other institutions; this is the fact that monetary policy in Canada is implemented by actions which bear directly on the cash position, and hence the financing opportunities, of the chartered banks, and only indirectly, if at all, on the financing opportunities available to competing institutions. Since these other institutions do not have statutory cash reserve requirements and are not bound by the 6% interest rate maximum, they are able, during a period when the authorities wish to contract or restrict the growth of credit, to continue to expand their credit operations and to take advantage of whatever may be the prevailing rate of interest. Since the central bank does not have the power to control their operations, even tighter restrictions have to be imposed on the chartered banks in order to keep the total amount of financing in the country within the limit desired by the central bank authorities. This is clearly a serious defect in the arrangements for implementing monetary policy, and one which imposes special costs and restrictions on the chartered banks substantially limiting their ability to compete effectively.

454. Another important legal limitation on the competitive position of the chartered banks is the prohibition in the Bank Act of investing by chartered banks in mortgages, with the exception of those allowed under the National Housing Act. This prohibition means that the public is largely prevented, when seeking mortgage money, from approaching the chartered banks as one possible source of the funds required. The field is therefore left open to a range of other lenders who are inhibited neither by government regulation nor by the possibility of competitive action by the chartered banks.

General Conclusion in regard to Competition with other Financial Institutions

455. What should be the goal of national policy in this whole matter of the type and variety of financial institutions available to serve the Canadian economy? It is our view that the goal should be to have a wide range and great flexibility in the financial services available to the Canadian public; that this can best be achieved by permitting the free play of competitive forces among the various institutions involved, including the chartered banks, without discriminatory restrictions which work to the disadvantage of one type of institution. At the present time the chartered banks are prevented by various legal and institutional rigidities from competing fully and effectively over the whole range of financing activities with the other institutions listed above. This means that the Canadian public, in seeking to satisfy its various financial requirements, frequently finds that for certain of these requirements

the chartered banks must be ruled out as possible suppliers. The result is that for a considerable range of financial activity the other institutions are sheltered from the competition which could otherwise be available from the chartered banks and which could not fail to strengthen the position of the Canadian public as it weighs and compares alternative sources of financing.

456. So far as possible the solution should lie in the direction of allowing free competition and the play of normal market forces as between competing financial institutions. Some regulations and controls there will undoubtedly be, intended either to safeguard the interests of the public or to facilitate the implementation of official monetary and fiscal policies. To the extent that this is practicable and possible, such controls and regulations should bear equally on all competitors in the field. From the point of view of competition with near-bank institutions, the preferable solution to the legal maximum interest rate problem would appear to be to give the banks the same competitive flexibility now enjoyed by the other institutions, i.e., to eliminate the legal maximum. This, particularly if combined with broader lending powers, would permit the chartered banks to compete on equal terms with other institutions now attracting a rapidly growing share of the savings deposits and loanable funds of Canadians.

SECTION III

DEBT MANAGEMENT

457. In the period since the Conversion Loan there have been a number of changes in debt management policy and techniques. With a heavy program of deficit financing and a sensitive bond market the Government has adopted a policy of offering relatively small issues of shorter-term bonds at fairly frequent intervals. Recent techniques have frequently involved the purchase of a substantial portion of each new issue by the Bank of Canada, and the gradual feeding out of this issue to the market over a period of weeks or months. The open-market buying of Government of Canada issues outstanding having the shortest maturity. This "leap-frogging" technique has proved helpful during a period when confidence in the market was low.

458. At present, when a new Government bond issue is offered the banks are assigned relatively small firm allotments of bonds. The initial allotment is based on past performance in the distribution of recent Government issues. The bank is free to divide its allotment of bonds among its investment account, its trading account for distribution to its customers, and its pension fund as it sees fit. The firm allotment may be less than the amount the bank would like to have for its own investment account. On the basis of the primary firm allotment the bank can usually submit a further order up to twice the amount of the firm allotment. On recent issues, however, the amount available for further orders

has been much smaller than the orders, and the second allotment has been relatively small. Thus if a bank wants a substantial amount of a new issue it must go to the dealers.

459. The main advantage of this system is that more bank transactions go through dealers, who would otherwise be penalized, under current conditions, by the fact that the Bank of Canada has taken on some of the secondary distribution of bonds, as well as by the generally smaller commission payable on shorter-term issues. Previously banks received larger initial allotments specifically for their investment accounts, the transactions were done directly with the banks and the dealers did not participate or know how big bank orders had been. (This arrangement was less costly to the Government than the present system, because the banks paid the full issue price for bonds for their investment accounts, whereas at present more bonds are sold first to dealers, who pay a little less than issue price.) The present system appears to be well-suited to current conditions, though it might not work as well if conditions were to change.

460. Although we are satisfied on the whole with the way debt management policy has been developing recently, it is open to some criticisms. The "leap-frogging" technique has been accompanied by more or less overt attempts on the part of the authorities to influence the selling behaviour of the dealers by inducing them to withhold new short-term issues from the banks and offer them instead to the non-bank market. This

behaviour on the part of the authorities indicates preconceived ideas on their part regarding the appropriate maturity structure of the banks' portfolios.

461. It is probably fair to say that the banks are unanimous in deprecating this practice. It is our view that, once the terms of an issue have been decided upon, the market should operate freely in determining its distribution as between bank and non-bank investors. Any other view of the market would imply the creation of rigidities and barriers between different types of investors, which would inhibit rather than assist the growth of an effective market.

462. While recognizing that in the short run monetary policy must take some account of the needs of debt management we believe that the central bank should not manipulate the cash position of the banking system from week to week in order to aid in the distribution of new Government issues. Before 1960 it was the practice of the Bank of Canada to ease bank cash two or three weeks before an issue was to be offered and then tighten up again after the offering, and more recently the technique has been reversed, with the Bank tightening up before an issue and easing afterwards. In effect, both these techniques mean using monetary policy, which is designed to work over a period of months, for short-term ends, thus disrupting the market and creating a degree of uncertainty as to the direction of monetary policy itself.

463. On the technical side the Bank of Canada has been accused of erratic behaviour in its after-market

operations with those parts of new issues which it has taken up itself. The criticisms relate to the Bank's hours of trading, amounts of bonds offered at different times, and prices quoted. We are inclined to think that the operations of the Bank of Canada are seriously handicapped by being geographically separated from and out of touch with the major markets in Toronto and Montreal. The situation would be improved if the Bank were to maintain senior officers in both centres with sufficient authority to make on-the-spot trading decisions.

464. We believe that the system of Treasury bill auctions has worked well on the whole. In the past it has been suggested that all Treasury bill transactions should be put through dealers, and that banks should not bid directly for bills at the tender. We would not be in favour of such a change, which in our opinion would be detrimental to the maintenance of an adequately broad market. Further, as active participants, the banks require to be familiar with the money market in all its phases, including the assessment of the market itself which is a part of the regular weekly bill tender.

465. The banks do not have uniform views on what constitutes an appropriate structure for the federal debt. Recent experience suggests, however, that the general public at present prefer to hold Savings Bonds rather than market instruments. Some people conclude that most Government financing should be done in the short-term market, with no particular effort to sell longer-term market bonds except by making them available through the Bank of Canada, as has been done during the

past two years. Others would argue that there should be regular public offerings of long-term bonds at whatever prices may be necessary.

466. We believe that the Federal debt should continue to be managed by the Department of Finance, using the Bank of Canada in an advisory capacity only. We would not be in favour of setting up an independent body to make debt management decisions. Debt management techniques, however, would probably be improved if either the Department of Finance or the Bank of Canada were to consult banks, investment dealers, and institutional buyers on a regular basis as is done in the United States before the timing and terms of Government issues are decided.

SECTION IV

TECHNIQUES OF MONETARY CONTROL

Cash Management

467. To exercise control over the volume of bank credit, the central bank has only to regulate the supply of bank cash relative to the needs of the banking system for cash. The central bank, through its control of bank cash, can provide the banking system with surplus cash at any given moment, thus permitting the system to expand. Or, the central bank can withdraw cash from the system, leaving it with less cash than it requires, thus forcing the system to contract.

468. Technically, control over the banking system could be maintained in this way by the central bank even in the absence of legal or agreed cash requirements. Banks would still have to hold adequate cash for working purposes just as do most other economic units, but presumably would not hold unnecessary idle cash. Central-bank control would be a matter of adjusting the supply of bank cash relative to these working requirements in order to create a cash deficiency or excess so as to encourage the banking system to expand or contract.

469. There may be circumstances in which a central bank finds it awkward to supply or withdraw bank cash exactly as it desires in order to maintain control over the banking system. Such circumstances may arise, for example, because of debt management considerations or when the bond market is thin or disorganized. At such times a legal cash reserve ratio may assist the

implementation of monetary policy.

470. Proposals for tying legal requirements to different classes of deposits, to different categories of assets, or to bank debits are alternative ways of providing for the automatic release or absorption of bank cash with a view to supplementing or replacing discretionary monetary control. It is our view that complicated devices for making monetary policy more automatic do not offer much promise of improving the effectiveness of monetary control.

471. Our view of central-bank cash management techniques is that, in general, they should operate smoothly and continuously and be capable of tailoring cash changes as precisely as possible to fit the day-to-day needs of monetary policy. They are then least disruptive to the normal operations of the banks. From this point of view open-market operations are by far the best technique of central-bank cash management. Recourse to open-market operations, however, requires a well-developed dealer market for financial assets.

472. The Bank of Canada could also manage bank cash in a general way by extending loans to the chartered banks, money-market dealers, and the federal government, rather than by buying and selling securities in an open market. Loans, however, cannot be administered as flexibly as can a securities portfolio, and for this reason central-bank lending is best restricted to a last-resort basis.

473. All other techniques of central-bank cash management seem best left for emergency situations in

which the state of the money market prevents the use of open-market operations. Such techniques do not work through the market and so are more arbitrary and less easily understood. Under a regime of managed money it is desirable that the methods of management be clear in order to minimize the danger of creating undesirable uncertainties in the minds of the public.

Other Monetary Control Techniques

474. Recourse is sometimes had to a so-called liquid-asset ratio as a device for central-bank control over the banking system, as for example the agreement by Canadian chartered banks that they will hold a combination of cash, day-to-day loans, and Treasury bills amounting to not less than 15% of their deposit liabilities, computed similarly to the 8% cash ratio. As long as the central bank has firm control over bank cash, however, it does not require a liquid-asset ratio in order to regulate the banking system. It is only necessary to fall back on a liquidity ratio for this purpose when the central bank is unable or unwilling to prevent the banking system from adding to its cash reserves by disposing of liquid assets, as can happen when the central bank is committed to supporting government security prices.

475. However, a liquid-asset ratio may be used to restrain the banks from switching out of more liquid assets into less liquid ones, such as loans. Alternatively, such shifts may be discouraged by a sufficient reduction of bank cash through open-market operations. If the market is unable to support the volume of open-

market operations necessary for this, a liquid-asset ratio may serve as a useful stop-gap measure; nevertheless the longer-run solution is to develop better markets.

476. It is our view that giving legal status to a liquid-asset ratio is neither necessary nor desirable. Only the holdings in excess of the stipulated minimum can be considered as a true liquid reserve, so an irreducible portfolio of low-yielding assets tends to make bank operations more expensive qithout benefitting the banks or their customers. Moreover, such provisions tend to be inflexible and slow to change in the face of changing conditions. Indeed there is a real risk that each new credit crisis will bring an increase in the stipulated ratio in order to prevent the banks making use of any cushion of true liquidity they may have succeeded in building up, with the result that the situation will become progressively worse. It follows that, if expediency dictates recourse to a stipulated liquid-asset ratio, it should be withdrawn as soon as more permanent remedies can be applied.

477. No doubt other ratios besides a cash or liquid-asset ratio could be devised for implementing and aiding control. It is our view that such ratios, like liquid-asset ratios, are not necessary when money markets are adequate to permit the central bank to exercise its control through open-market operations. If the use of liquid-asset or similar ratios cannot be avoided, they should be imposed for only as long as they are needed, and they should certainly not be

maintained for so long that they weaken the incentive to develop better financial markets. In short, it is our view that the emphasis in monetary control should be on bettering financial markets for making open-market operations more effective rather than on devising new methods of control.

Bank Rate

478. Functions of Bank Rate. In Canada, "Bank Rate", the minimum rate at which the Bank of Canada is prepared to make loans or advances can, or could, perform two important functions, to regulate the access of the money market to central-bank credit, and to provide a signal of central-bank intentions.

479. The first function is necessary for times of restraint to prevent the money market from having ready resort to central-bank credit when the central bank is trying to restrict the amount of its credit outstanding. For this purpose Bank Rate must be a penalty rate in the sense that it makes borrowing from the central bank a more expensive way of raising cash than selling marketable financial assets or borrowing elsewhere. This ensures that the market only turns to the central bank for accommodation as a last resort. Such resort is necessary for non-bank money-market dealers when they are unable to finance their inventories of securities through the banks or through any other source. For banks too it is necessary to have access to such a lender of last resort to ensure that they will always be able to comply with the law on cash requirements.

480. The second function of Bank Rate, that of

signalling, is especially important at times of major changes or shifts in monetary policy, or at times when there would otherwise be great doubt about whether or not policy had changed. It is the more difficult function to explain. If Bank Rate is to be a signal of anything, it must reflect the actual or intended cost of additional central-bank credit, for intentions must be supported by action if the intentions are to mean anything at all. In this sense Bank Rate can be a sign, with the central bank setting the rate higher when it believes economic conditions warrant higher interest rates in general and setting it lower in the opposite situation. Not only the direction of a deliberate change in Bank Rate but also the level of the rate would be a signal of central-bank intentions. If it were the intention of the central bank to apply monetary restraint, a discretionary action to raise Bank Rate, and to keep it at a higher level than previously, would serve as a signal of intent, and would be especially useful at times when there was any widespread uncertainty about the intent of monetary policy. When a central bank is trying to influence the economy in a particular direction, it makes sense for the central bank to indicate the direction of movement it desires. Such an indication would certainly enable the banking system to respond faster than it now does to the market pressures exerted on it by the central bank.

481. The present method of setting Bank Rate in Canada at 0.25 per cent above the latest weekly average yield on accepted tenders for three-month Treasury bills

provides a Bank Rate that functions satisfactorily as a penalty rate. The money-market dealers are assured of a rate which, though involving a penalty, accurately reflects the market. The Rate floats from week to week and in so doing exacts a penalty from dealers who have to borrow from the Bank of Canada that is neither excessive nor insufficient -- as it would be if a "fixed" Bank Rate were respectively high or low relative to market rates. In lending to the chartered banks the Bank of Canada imposes additional restrictions which do not apply on accommodation granted to money-market dealers, and these restrictions add to the penalty exacted from the banks by the floating Bank Rate. These restrictions relate to the borrowing limits, term, and conditions of renewal.

482. <u>Other Methods of Signalling</u>. A major disadvantage of the floating Bank Rate as it now operates is that it gives no clear indication of central-bank policy; yet this is a traditional function of Bank Rate -- to provide a clear and unmistakable signal of central-bank intentions. There is no adequate substitute for Bank Rate in the performance of this signalling function. At first glance it might be thought that simple statements of intentions by the appropriate officials would serve as well. While these are extremely useful, they require a good deal of interpretation, especially when they are general and expressed in non-quantitative terms. Furthermore, the multiplicity of objectives that monetary policy may be used to pursue adds to the difficulty of framing simple

statements of intentions.

483. Statements that express intentions in quantitative terms might be expected to have a greater impact, but here it is important to distinguish between economic objectives on the one hand and policy indicators on the other. Objectives are external to the central bank and are outside its direct control; policy indicators are internal to the operations of the central bank and so are controlled directly by it. The former are goals which a central bank may seek to attain by means of the policy instruments at its disposal. Such objectives could relate to money supply, bond prices, national income and expenditure, or general prices. It would be possible for statements of intentions to assign a value to such an objective, say the money supply, thus indicating that the central bank was going to try to keep the money supply at some particular level.

484. Specifying figures for objectives that cannot always be fully achieved runs the risk of discrediting the intentions. For example, there is no doubt that in the longer run the monetary authorities can make the money supply what they want, but such precision is not possible in the short run. For this reason, the prevailing level of the money supply, and use of quantitative objectives in general does not make a good signalling device, for it indicates only the success or failure of what monetary policy is trying to accomplish.

485. Specifying figures for policy indicators is another matter, however. The two most significant

indicators of this nature are the amount and the cost of central-bank credit. These are more directly controlled by the central bank than the more remote objectives, and statements about either could serve as a signal of central-bank intentions. Thus, the signal could be in terms of the amount of cash reserves that will be made available. It is more usual, however, to post the cost or price at which amounts will be provided rather than to state the amount that will be supplied. A price or a rate takes into account both demand and supply, whereas specifying an amount does not. For this reason a "price" signal is better than an "amount" signal, and hence posting a Bank Rate, in some way, provides a better signal than posting or setting a figure for cash reserves, and it allows more scope for flexibility. Of course, to be a satisfactory signal the central bank must endeavour to make its Bank Rate effective by trying to make the cost of additional central-bank credit conform to the Rate specified.

486. Bank Rate as a Signal. The basic problem in using Bank Rate as a signal is to retain its function as an appropriate penalty rate without compromising its signalling function. A return to a conventional Bank Rate, which changes only at the discretion of the central bank, may not solve this problem. A Rate fixed to conform to the policy intentions of the central bank might at times be "off the market" so that it would confront the money-market dealers either with too severe a penalty or

with an inducement to borrow from the central bank. Yet to move the Bank Rate to correct these technical situations entails the risk of having such changes misinterpreted as policy changes, when in fact the Rate is only following the market.

487. Having a dual Rate seems a way out. The penalty Rate could float as at present and serve as the Rate at which both money-market dealers and banks receive accommodation from the central bank. The "signalling" Rate would be a discretionary rate fixed independently of the floating rate and fixed at a level deemed appropriate for the times. The fixed Rate might conceivably be used as well for the Rate at which the chartered banks could borrow from the central bank, leaving only the security dealers to borrow at the floating rate. So long as the central bank was trying to make the cost of additional central-bank credit conform to the fixed Rate, the action of the market would keep the floating Rate from ever being far from the fixed Rate. Temporary slippages in monetary control might cause the floating Rate to deviate from the fixed Rate but large or prolonged deviations would be unlikely. Since the fixed Rate would be changed in keeping with the changing needs of monetary policy, there would be no question of the central bank pegging interest rates.

488. Another possibility is to retain the present floating Rate but to alter the spread between the three-month Treasury bill rate and Bank Rate, making the spread more than 0.25 per cent when monetary policy

shifts to tightness and less than 0.25 per cent when the policy is to ease. The size of the spread would be the signal of central-bank intentions. It would reflect the penalty imposed on dealers and banks when they borrowed from the central bank, and the reasoning is that the penalty should be more severe when the central bank intends to exercise restraint than when it is trying to keep monetary conditions easy. It can be argued, however, that the penalty should be constant so as not to disturb market relationships. Indeed the proponents of this scheme realize that large variations in the penalty are undesirable. Yet if changes in the spread are restricted to changes so small that they do not significantly affect the severity of the penalty imposed by the central bank, the changes become little more than symbolic. Furthermore, changes in the spread would be open to misinterpretation if by chance market rates and Bank Rate went one way while the spread went the other way. Still, a variable spread would be better than no signal and is worth further thought.

489. Yet another possibility is to retain the floating Rate as a general practice but to substitute a fixed Rate when a signal is required. At all other times when a signal is not required the Rate would be allowed to float. A possible disadvantage of this method is that it might disturb the money market unduly. The authorities might be reluctant to depart from the floating Rate at times for fear that the change in the method of setting the rate (as distinct

from a mere change in the rate itself) would have exaggerated effects on market psychology.

490. Impact of the Rate. The impact of changes in Bank Rate on the activities of the chartered banks could be quite significant even though chartered-bank borrowing from the Bank of Canada is infrequent. To have an impact the changes in Rate must be more than nominal and must be supported by open-market operations or other appropriate cash management techniques. A noticeable change in the Bank Rate initiated by the Bank of Canada would have an indirect cost effect for the banks as steps were taken to make the Rate effective. Money-market conditions would tend to conform to the new cost for central-bank credit and these conditions would affect the cash adjustment and investment policies of the banks, for these policies are very sensitive to money-market conditions. Thus, Bank Rate may affect the chartered banks in terms of costs even though the banks do not borrow from the Bank of Canada and bank lending and deposit rates are not tied to Bank Rate.

491. Changes in Bank Rate, functioning as a signal of central-bank intentions, would serve to augment the cost effects by causing them to act faster on the lending policies of the banks. Once the signal was given, banks would take steps immediately to ease or to tighten lending policies to conform with the message provided by the signal. That is, knowing in what direction the central bank was trying to drive the banking system, the banks would alter those lending

activities less sensitive to money-market conditions in keeping with the monetary policy indicated.

492. The impact of changes in Bank Rate on the activity of chartered-bank customers depends on how sensitive these customers are to money-market conditions and to conditions in credit markets in general. There is no doubt that changes in Bank Rate, made effective by Bank of Canada action, influence the financing and investing activities of many corporations which in turn would influence the activities of smaller customers. As far as cost effects alone are concerned, the activity of bank customers would tend to vary inversely with changes in Bank Rate.

493. It has been argued, however, that changes in Bank Rate, acting as a signal of central-bank intentions, would cause perverse reactions by the public. A rise in Bank Rate would be seen as confirmation of an expanding situation which should be taken advantage of by expanding one's own activity. There is no way around such a difficulty. Expectations of this nature, no matter on what facts they are founded, will often lead to actions contrary to the best interests of economic stabilization. Failure to provide a signal of central-bank intentions will inhibit such perverse reactions in periods of great uncertainty about the state of the economy but it will also inhibit the response of the banking system to monetary policy, thus slowing down the implementation of positive measures to alter the state of the economy.

Other Communications and Contacts

494. A central bank is responsible for the day-to-day implementation of monetary policy, and it has a corresponding duty to offer full explanations of its policy. The use of Bank Rate as a signal of central-bank intentions does not eliminate the need for frequent and fuller public statements by a central bank about what its monetary policy is at any given time. The complexity of modern financial environments makes it all the more imperative that the maximum of information be provided.

495. The general argument against fuller disclosure seems to be that it would reduce the freedom of action of the central bank. There are times, it is argued, when monetary policy is a matter of probing the market as part of the process of shaping that policy. At such times no firm policy announcement can be made, and to announce what was being done would destroy the usefulness of all exploratory action. This argument would rule out statements about policy in times when the central bank is not embarking on a major shift in policy and is in fact feeling its way. But once a particular policy action has been decided upon there should be a clear statement of what that action is.

496. When more than exploratory action is being undertaken, the argument against disclosure of policy is that it would disturb the money market. A good market requires some uncertainty, and it is feared that a statement of policy would eliminate that uncertainty.

The market would know what to expect and would move immediately to whatever price seemed implied by the statement. This, it is contended, would subject the money market to disruptive swings in prices and yields which would serve no useful purpose. The answer to this is that disclosing the direction in which the central bank wishes the banking system to move does not require disclosing the amounts and prices at which the central bank will be operating in the market. Furthermore, such statements can surely be timed to come after the completion of the basic transactions required to affect the banking system.

497. A clear statement of policy may still cause an abrupt change in prices and yields in the money market, but at a time when a major shift in policy is under way a change of this nature is not necessarily undesirable. Such a statement of policy is extremely useful in clearing up any doubts of the banks as to how the central bank wants them to respond to its pressures. Informing the public as well as the banks on policy also aids the task of the banks in co-operating with the central bank in implementing the policy.

498. In addition to a signal of central-bank intentions and to full disclosure of monetary policy, we believe it is essential that the banks and the monetary authorities continue to maintain close contacts with each other. It is also essential to have close and effective co-operation between the Bank of Canada and the Government of the day. In our view the Government

must have the ultimate responsibility for monetary policy objectives, while the Bank must have responsibility for carrying out day-to-day operations within the framework of these fundamental policies.

Tied or Linked Rates

499. It has been suggested that bank lending rates be linked or tied to a Bank Rate functioning as a signal of central-bank intentions -- that is, a conventional Bank Rate -- along the lines of arrangements in England. This is not as desirable as it may seem at first glance. Ideally, bank lending rates should move with market rates and not with a manipulated non-market rate, which is what a discretionary Bank Rate is. By its very nature, Bank Rate at times will move ahead of the market and at other times will lag behind it. Bank lending rates tied to Bank Rate would then be out of line with the market. For full effectiveness it would also seem necessary to include all lenders in the scheme by linking their rates to Bank Rate. It would be inequitable to require chartered-bank lending rates to follow Bank Rate while other lending rates are free to move with the market.

500. It has also been suggested that deposit rates should be tied to Bank Rate, or that there should be a fixed spread between lending and deposit rates. It should of course be noted that market forces would cause bank lending and deposit rates to move more or less together anyway, but tied rates would introduce unnecessary rigidities. Fixing the spread between bank deposit and lending rates while leaving the spread

between the borrowing and lending rates of other institutions free would place the banks at a new competitive disadvantage.

501. Further disadvantages stem from the fact that the interest-bearing deposits that would be affected by tied rates substantially exceed the loans that would be similarly affected. The difference between the two depends on the state of the economy; in slack times, all other things being equal, loans will be lower and savings deposits higher than in times of boom. In the absence of compulsion and with complete freedom of movement, the spread that the banks can afford to allow will partly depend on how large the difference is. The greater the excess of savings deposits over loans the less the banks can afford to pay on deposits relative to lending rates and vice versa. Hence, the spread between lending and deposit rates would naturally tend to widen in slack times and to narrow in times of monetary restraint. But this is exactly what is required to help implement a stabilizing monetary policy. In slack times the accumulation of savings deposits tends to be discouraged by a lower rate; in times of boom, the accumulation of savings deposits tends to be encouraged by a rise in the deposit rate relative to lending rates -- a rise that would be ruled out by a fixed spread.

502. Introducing a fixed spread between lending and deposit rates would do away with the stabilizing movement in the natural spread between lending and

deposit rates. Banks would be reluctant to narrow the spread in times of monetary restraint for fear that this might become the new imposed spread, and they would be unable to widen the spread in a recession. Complete freedom of movement for both lending and deposit rates would ensure not only that depositors shared to the fullest extent possible in the loan revenues of the banks but also that the best interest of monetary policy would be served as well.

Compensating Balances

503. Requiring compensating balances from borrowers fits into a discussion of interest rates because such a requirement is generally viewed as a means of increasing the effective rate of interest on a loan. This, however, is not necessarily the case. If the compensating balances required were no larger than the working balances ordinarily carried by borrowers, nothing would be gained by requiring such balances. Only when compensating balances are in excess of ordinary working balances would the cost of bank credit to borrowers be raised. But this can be achieved more simply through higher interest rates, which are to be preferred because they state precisely the cost to the borrower. To require compensating balances disguises the true cost of credit to the borrower.

504. It might be argued that compulsory compensating balances would have the advantage of requiring borrowers to maintain balances sufficient to compensate the banks for the activity in their accounts. The best way to achieve this, however, is to levy service charges

on all clients, including borrowers, who fail to keep adequate balances to cover the cost of managing their accounts. This permits an individual approach aimed directly at the accounts concerned and is a fairer approach than a uniform provision for compensating balances.

505. Although it would not be practical to impose compensating balances on all borrowers, a case could be made from the point of view of monetary control for enabling banks to require compensating balances from borrowers under lines of credit. Such requirements could be varied according to the state of business and would serve as a substitute for alterations in lending rates. Bank credit would then become more expensive in a boom and less expensive in a recession even though lending rates remained constant. But, again, this seems less desirable from the economic point of view than simply setting interest rates free.

SECTION V

STATISTICAL GAPS

506. We have been asked for our views as to the adequacy of statistical and financial information in Canada. The information now made available by the chartered banks on their own operations seems to us fairly comprehensive, but we believe that other financial institutions should be required to produce fuller and more frequent data on their assets, liabilities, and transactions, with due consideration for the problem of comparable valuation. We should also like to see more work done on the savings-investment flow in Canada. This would require better statistics on the sources and uses of funds.

507. Among the figures we believe should be made available are:

(a) the Government's cash receipts and expenditures on a weekly basis for major items and on a monthly basis in detail, also the Government's overall financial statement for the month of March each year, at present missing from the monthly series.

(b) Weekly figures for the holdings of the Purchase Fund, the Securities Investment Account, and the Exchange Fund (including a classification by currencies).

(c) The Bank of Canada's balance sheet as a weekly average of daily figures, and the Bank of Canada's detailed profit and loss statement

monthly.

(d) Detailed monthly or quarterly statements of the assets and liabilities of near-bank financial institutions, valued on a comparable basis, and information on the "chequing" operations of these intermediaries.

(e) A monthly or quarterly classification of assets held in trust and administered by trust companies, showing the distribution of these funds by major asset and by currency on an agreed basis of valuation.

(f) Broader coverage of both insurance companies and trust and loan companies, whose operations are now reported on a sample basis by the Bank of Canada.

(g) Weekly figures on the money-market, including dealer positions, transactions, and borrowings.

(h) Figures on direct new issues of securities by provinces, municipalities, and corporations, including parity bonds and money market issues, classified by borrower and by terms of issue including yields.

(i) Resumption of the "Direct Estimate of Personal Savings" formerly published by the Bank of Canada.

APPENDIX

THE CANADIAN PAYMENTS AND CLEARING SYSTEM

PAYMENT INSTRUMENTS IN USE

1. The Royal Commission staff has requested a brief summary of the Canadian "payments system". A list of the instruments in use in Canada, with an indication of the annual volume of items in each case where this information is available, follows:

Items	Annual Volume (in millions)
1. Cheques	693
2. Orders drawn on near-banks	14
3. Bank money orders, drafts and travellers' cheques	9
4. Postal money orders	50
5. Canadian National and Canadian Pacific Express money orders	included in (1)
6. Grain tickets	3
7. Coupons	18
8. Pre-authorized cheques - so far confined to specifically named insurance companies	included in (1)
9. Settlements between banks and branches and the Bank of Canada	11
10. Collections, i.e. bills of exchange and promissory notes, the proceeds of which are "collected" for customers	10

11.	Mail and telegraphic transfers	3
12.	Acceptance of payment of accounts (including utilities, taxes, insurance premiums, etc.)	19
13.	Standing orders - (customers' instructions to pay at stated intervals)	Not known

In addition to these items handled in Canadian funds, some 11 million drafts, money orders and cheques in U.S. funds are handled through the system.

Negotiable Instruments

2. Items numbered 1 to 9 inclusive are themselves negotiable instruments and may be presented through the chartered banks' clearing system. Indeed, of the more than 700 million cheques negotiated in Canada per annum some 568 million pass through the clearing system, the remainder being charged to accounts at negotiating branches.

3. Item 10, "Collections" is the service provided by the banks in arranging for presentation for acceptance and payments of bills of exchange drawn by creditors upon debtors. The prevailing rates charged by banks for this service are not adequate to cover the costs involved, and it is questionable whether there is a continuing need in Canada for the "inland bill" when it has fallen into disuse in many other advanced countries. Although there does seem to be a general trend away from this type of settlement, it persists in certain industries and in others is unique to specific companies. The most obvious example is the needle trade where the drawing of drafts is traditional and

where, in addition, the drafts themselves are pledged as collateral with the banks, which, as a rule, are prepared to advance funds against them, subject to a margin determined by the standing of the customer. Upon payment of such bills on due date, the bank acting as collection agent remits to the creditor's bank for his credit, by means of a bank settlement which is passed through the clearings.

Credit Transfers

4. Item 11, "Mail and telegraphic transfers", are transfers of funds made by one branch bank to another, usually at the request of a customer, but not restricted thereto. Item 12, "Acceptance of payment of accounts", is an arrangement entered into at the request of, say, a utility company whereby payment of periodic accounts may be made at a branch bank by the general public. The number of such arrangements is gradually increasing. Both processes 11 and 12 result in settlement vouchers of one kind or another which pass through the clearings.

5. Item 13, as indicated, is a mandate from a customer to his banker instructing him to make certain periodic payments on his behalf. Although such arrangements are provided for in the Canadian system, and are the subject of scheduled charges, this device has not been utilized in Canada to the extent prevailing in England. Within the banking system, the difference in approach between the two countries lies in the clearing process, in that the English system is based on credit transfer while the Canadian system

relies on the principle of debit clearings. At this point we should note that the number of transactions financed by debit transfers in Canada is running at 792 million per annum, as compared with 22 million by credit transfer.

6. In England this type of mandate is used to some extent for payment of insurance premiums, and it could be said that Canada has a somewhat comparable arrangement in the "pre-authorized" cheque plan which has been in operation for the past three years. This is a mandate from a debtor to a creditor, in this case an insurance company, authorizing the latter to draw against the bank account of the policy holder, on a monthly basis, for certain specified amounts.

Near-Banks' Access to the Chartered Banks' Clearing System

7. An important element in the relations between the Chartered Banks and other financial institutions is the provision by the banks of clearing facilities.

8. In Canada, the mediums of exchange and means of payment used by the general public are coin, Bank of Canada notes, and cheques, the latter being used in the great majority of daily business transactions. The acceptability of cheques as a medium of exchange depends upon the ease with which they can be negotiated, either for cash or for deposit, and upon the existence of adequate and efficient clearing facilities whereby negotiating banks can obtain the earliest possible reimbursement for cheques negotiated. Such clearing facilities are provided and maintained by the

Canadian banks and settlement between banks is effected through accounts with the Bank of Canada by the Head Offices of the banks. The banks are constantly improving the efficiency of their clearings system by adopting up-to-date methods and are presently formulating plans for the introduction of electronic sorting of cheques.

9. A basic feature of the inter-bank arrangements for the clearing of cheques is that local cheques are cleared locally and all out-of-town cheques are cleared to the negotiating bank's main branch at the nearest central clearing point; there, cheques on other banks are redeemed by the drawee bank which clears them to its branches on which they are drawn. This method, adopted in June 1960, has proven to be highly satisfactory and much more efficient than the former method whereby cheques on other banks were cleared by the negotiating bank to its own branch at the point on which the cheques are drawn and cheques on non-bank points through the central clearing point.

10. Cheques, as defined in the Bills of Exchange Act, are bills of exchange payable on demand and drawn on a bank. In addition to these cheques there has grown up in Canada the use of a type of near cheque - more properly termed a payment order - drawn on organizations such as credit unions and caisses populaires, provincial treasury branches and savings offices in Alberta and Ontario, and a growing number of companies in the trust, loan and mortgage field (mainly trust companies). As already indicated, these

organizations are not only in aggressive competition with the banks for savings deposits, but most of them also offer an extensive variety of banking facilities and services, including loans (personal, business and mortgage), safety deposit boxes, safekeeping of securities, money transfers, and "chequing" facilities. The last-mentioned, which is an important factor in enabling these organizations to offer banking facilities comparable to those provided by the banks, is made possible by the co-operation of the banks in extending to these organizations clearing privileges under which orders drawn on them by their customers and cheques negotiated by them for their customers are cleared through the clearing facilities maintained by the banks.

11. The clearing privileges referred to above are made available on reasonable terms and conditions (outlined below), subject only to approval by the organization's bankers and the formality of approval by the local clearing house, if any, and The Canadian Bankers' Association. There is no record of clearing privileges having been denied, but no doubt the privileges would be withdrawn in the event of an organization getting into financial difficulties. It should also be noted that a cost analysis has shown that the average cost of handling one item through the clearing system exceeds the 5¢ clearing fee now charged on credit union and trust company orders.

12. The volume of orders referred to above handled through the banks' clearing system is very substantial, as indicated by the following estimate for the

year 1961 which is based upon the latest figures available:

Organization	Total Number of Orders	Total Amount
Caisses Populaires - Province of Quebec	8,000,000	$ 875,000,000
Credit Unions -		
Ontario	275,000	$ 46,775,000
Saskatchewan	593,000	$ 107,626,000
British Columbia	393,000	$ 76,555,000
Other provinces	Not available	
Province of Alberta Treasury Branches	2,600,000	$ 260,000,000
Province of Ontario Savings Offices	1,200,000	$ 120,000,000
Trust Companies	Not available	
	13,043,000	$1,485,956,000

13. In addition to the heavy volume of orders, the banks also handle for the near-banks the clearing of a comparable volume of cheques negotiated by them for their customers. The terms on which orders and cheques are cleared by the banks are outlined in the following paragraphs.

Credit Unions (Caisses Populaires) in the Province of Quebec

14. Of the 1424 caisses populaires in the Province of Quebec, 1234 are affiliated with La Federation de

Quebec des Caisses Populaires Levis, 22 with La Federation de Montreal des Caisses Desjardins, Montreal, and 168 (which do not provide chequing facilities) with the Quebec Credit Union League. Central or regional caisses are located in Montreal (two Centrals), Quebec City, Amos, Bic, Joliette, Marie (Gaspe), Metabetchouan, St. Hyacinthe, Sherbrooke and Three Rivers.

15. The following are the clearing arrangements made:

(a) The Provincial Bank of Canada is the clearing bank for the caisses and Centrals at all points where that bank is represented; at other points other banks act as clearing banks.

(b) <u>Clearing Fee</u> - On orders negotiated by banks a clearing fee of 5¢ per order is charged to the caisse or Central to which the orders are cleared. The usual annual clearing house fee is not applied.

(c) <u>Local Items</u> - At all points where there are one or more banks and one or more caisses, local cheques and local orders negotiated locally are cleared locally between caisses and banks, settlement being made either through an account with the clearing bank or by means of settlement vouchers payable at par in Montreal or Quebec City.

(d) <u>Out-of-Town Orders</u> - Out-of-town orders negotiated by banks and settlement vouchers referred to in (c) above are sent to Montreal or

Quebec City where they are cleared through the clearing bank and charged to the Centrals' accounts. These Centrals clear the orders through the regional caisses where necessary, to the caisses on which they are drawn. The banks pay the Centrals 1/16% on the daily total of orders except those drawn on local caisses at the two clearing points.

(e) Out-of-Town Cheques - Out-of-town cheques negotiated by caisses are sent to the Central or regional caisse at the nearest of the ten points where there are Central or regional caisses. The Central deposits the cheques in the clearing bank which clears them at the following rates:

(1) Cheques issued by the Government of Canada or the province in which the branch is located. . . . . . . .no charge

(2) Cheques drawn on accounts at the branch where they are deposited. .no charge

(3) Grain and creamery tickets. . no charge

(4) Local clearing items. . . . . . . 2 1/2¢ each after allowing 4 free items for each $50 of minimum monthly credit balance in the Central's current account.

(5) Cheques on outside points:

Up to $5,000 each - 5¢ plus 1/10% on daily total.

Over $5,000 each...........1/16%, min. $5 on each item.

Credit Unions (Including Caisses Populaires) in Other Provinces

16. With few exceptions the 540 credit unions in Ontario, 271 in Saskatchewan and 316 in British Columbia which permit their customers to issue orders have arranged for centralized clearing through the central credit union for the province, viz:

Ontario Co-operative Credit Society, Toronto

Saskatchewan Co-operative Credit Society Ltd., Regina

British Columbia Central Credit Union, Vancouver

The clearing arrangements in these provinces are the same as for caisses populaires in Quebec, except as noted below. Each credit union outside the central clearing point conducts an account with a local bank through which local orders and cheques are cleared. Out-of-town orders and cheques are cleared through the Central. The Central conducts with each bank at the central clearing point an account to which orders negotiated by branches of that bank are charged and in which cheques payable at branches of that bank are deposited. As there are no regional credit unions, orders are cleared by the Centrals direct to the credit unions on which they are drawn and the 1/16% charge on out-of-town orders in Quebec does not apply.

17. The 408 credit unions in the Atlantic Provinces, 228 in Manitoba and 232 in Alberta have not made centralized clearing arrangements.

18. In these provinces orders negotiated by the banks are cleared by the banks to the points at which

the orders are payable, where they are charged to the credit union's bank account. The credit union pays the bank a clearing fee of 5¢ per order plus $100 annually and, where there is a clearing house, pays an annual fee of $100 to the clearing house. Cheques negotiated by each credit union are deposited in its local bank, which clears them at the following rates:

(1) Cheques issued by the Government Canada or the province in which the branch is located . . . . no charge

(2) Cheques drawn on accounts at the branch where they are deposited . no charge

(3) Grain and creamery tickets . . . . no charge

(4) Local clearing items . . . . . . 2 1/2¢ each after allowing 4 free items for each $50 of minimum monthly credit balance in the credit union's current account.

(5) Cheques on outside points . . regular rates.

Trust, Loan and Mortgage Companies

19. Although these companies have numerous offices across Canada (226 offices at the end of 1960), no company has yet undertaken the clearing of orders drawn on its out-of-town offices. Orders negotiated by the banks are cleared by the banks to the points on which the orders are drawn, where they are charged to the company's bank account. The company pays the bank a clearing fee of 5¢ per order plus $100 annually and, where there is a clearing house, pays an annual fee to

the clearing house, as follows:

At Toronto and Montreal $300

At Vancouver $150

At all other points where there is an established clearing house $100

Cheques negotiated by a company for its customers are deposited in its local bank, which clears them at the following rates:

Local cheques . . . . no charge

Out-of-town cheques:

$2,500 and under . . . . . 1/8%, min. 20¢

Over $2,500 and up to $10,000 . . . . 1/10%, min. $3.15

Over $10,000 subject to negotiation . . . . --   min. $10.00

Provincial Treasury Branches and Savings Offices

20. These provincial government institutions operate branches or offices in their respective provinces, as follows:

Province of Alberta Treasury Branches - 154 offices.

Province of Ontario Savings Offices   - 24 offices.

Orders drawn on these offices negotiated by the banks are cleared by the banks to the points at which the orders are payable, where they are charged to bank accounts of the institutions. An exception is that orders on Alberta Treasury Branches at non-bank points are cleared by the Treasury Branches at the following rates:

For Canadian Imperial Bank of Commerce - 1/10% on daily total

For other banks - 5¢ per item plus 1/10% on daily total

The only contribution by these institutions towards the banks' costs of clearing their orders is an inadequate fee of 1¢ per order (2¢ at a few points) plus clearing house annual fees at certain points paid by the Ontario Savings Offices, and annual fees totalling only $3,000 in all paid to banks and clearing houses by the Alberta Treasury Branches on 2.6 million orders. The matter of fees sufficient to cover the banks' costs is currently under discussion.

21. Cheques negotiated by Alberta Treasury Branches are cleared as follows. Cheques payable locally are cleared locally without charge. Out-of-town cheques are sent to the main Treasury Branch in Calgary, where they are deposited with the Canadian Imperial Bank of Commerce and cleared at the following rates:

On that bank's branch points - 1/10% on daily total

On other points - 5¢ per item plus 1/10% on daily total.

22. Cheques negotiated by the Ontario Savings Offices are deposited with local banks and cleared by the banks at rates somewhat lower than regular rates to the public.